July 16, 2020

Phil H. Mendelson, Chair
Council of the District of Columbia
Washington, DC 20004

Re: In Opposition to Advertising and Personal Information Tax Amendment Act of 2020, B23-760 & 761, Title VII, Subtitle L

Dear Chair Mendelson and Members of the Council:

The Council On State Taxation (COST) strongly opposes the Advertising and Personal Information Tax Amendment Act in the proposed Fiscal Year 2021 Budget Support Act of 2020 (B23-760), which would impose a 3% sales tax on advertising services, including digital advertising services, and personal information services. Several other jurisdictions have recently considered similar targeted sales tax base expansion to include advertising services and personal information services, but they were all unanimously rejected. If the District passes this proposal, it would be an outlier as the first jurisdiction to adopt such a targeted sales tax on these types of services. On a broader scale, the District’s expansion of the sales tax base to digital advertising services is inconsistent with the strong opposition of the U.S. Department of the Treasury to international digital services taxes.

With the rapid growth of the services sector in recent decades, it is understandable why a jurisdiction would want to expand its sales tax base to include more service categories. However, this proposal primarily targets services consumed by businesses, not those consumed by households, and it does not provide an exemption for business inputs. Indeed, it is difficult to identify any service categories more exclusively purchased by businesses, and not households, than advertising and personal information services. This proposed expansion of the sales tax base directly violates the economic principle that an ideal sales tax should exclude household consumption and not business inputs.¹ It represents unsound tax policy and violates several core tax policy principles—transparency, fairness, and economic neutrality.

The COVID-19 health and economic crisis has put significant fiscal pressure on both governments and businesses. But tax revenue is best generated from a robust and thriving business environment. Keeping businesses afloat after this crisis passes is imperative for future economic recovery, growth, and tax revenue. This proposal, however, will do just the opposite. It increases the burden on all businesses, adding an additional roadblock to recovery. This proposal also provides no guidance on how the tax should be implemented, which is further exacerbated by the rapid timeframe within which this proposal will go into effect, if passed.

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 550 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.

COST’s Position on Taxation of Business Inputs

The COST Board of Directors has adopted a formal policy position opposing the imposition of state sales tax on business inputs, which provides:

*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.*

This proposal is inconsistent with creating a more efficient and modern sales tax system. Imposing sales tax on business inputs specifically violates the tax policy principles of neutrality, equity, simplicity, and transparency, and it causes significant economic distortions. Taxing business inputs is inconsistent with the rationale for a sales tax designed to operate as a tax only on final household consumption; because businesses are not the final consumers of business input purchases, the sales tax should not apply to their purchases.3

Notably, these distortions result primarily from pyramiding. Pyramiding occurs when a tax is imposed at multiple levels that results in a hidden effective tax rate that exceeds the retail sales tax rate. Pyramiding forces companies to either pass these increased costs on to consumers or reduce their economic activity in the District to remain competitive with other producers who do not bear the burden of such increased taxes. Because of these choices, the economic burden of taxes on business inputs inevitably shifts to labor in the District (through lower wages and employment) or consumers (through higher prices).

This proposal would create other significant adverse economic distortions. For example:

- Taxing business inputs encourages companies to self-provide business services to avoid the tax rather than purchasing them from more efficient providers and paying tax (vertical integration);

---

• Taxing business inputs places companies selling in international, national and regional markets at a competitive disadvantage to many of their competitors, leading to a reduction in investment and employment in the District;

• Taxing business inputs unfairly and inefficiently taxes some products and services more than others by imposing varying degrees of tax on inputs in addition to a general tax rate on final sales;

• Taxing business inputs unfairly hides the true cost of government services by embedding a portion of the sales tax in the final price of goods and services; and

• Taxing business inputs increases administrative and compliance costs for tax administrators and taxpayers.

Finally, a sales tax on advertising services and personal information services creates significant cost disadvantages for small businesses. Small businesses are often less likely than large businesses to be able to vertically integrate. Without the means to compete with larger businesses that can vertically integrate and internalize certain costs, the demand for services provided by small businesses is reduced. Moreover, increased administrative and compliance costs are another strain for small businesses to absorb.

**No Administration or Implementation Guidance**

The proposal contains no guidance to determine whether a sale of advertising services or personal information services is subject to the sales tax; and if so, how it should be sourced. The Office of Tax and Revenue (OTR) has limited time to determine the appropriate guidance and regulations to administer this tax because if passed, the new tax would apply approximately by the end of the summer. And no preformulated guidance or regulation is readily available to the OTR from other states because of the novelty of this proposal. As a result, businesses will not know how to collect and remit this tax and may not have appropriate systems in place to comply. Such an environment will make it nearly impossible for businesses and the OTR to get it right.

**Conclusion**

The District, as with other state and local governments, faces revenue shortfalls arising from the COVID-19 crisis. To address this difficult fiscal situation, it is critical that any tax solutions not cause more harm than good by undermining economic recovery. This novel and complex tax of business purchases would significantly hurt recovery efforts. For the foregoing reasons, COST strongly urges the members of the District Council to vote “no” on the Advertising and Personal Information Tax Amendment Act.

Respectfully,

[Signature]

Stephanie T. Do

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