

**State Digital Ad Taxes:  
A Good and Permissible Idea  
(Despite What You Might Have Heard)**

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# Digital Platforms

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- Digital platforms give away “free” services, such as searching the web or social networking, to users.
- They operate other business lines, such as online advertising, and have the users watch ads and tender data.

amazon



Google

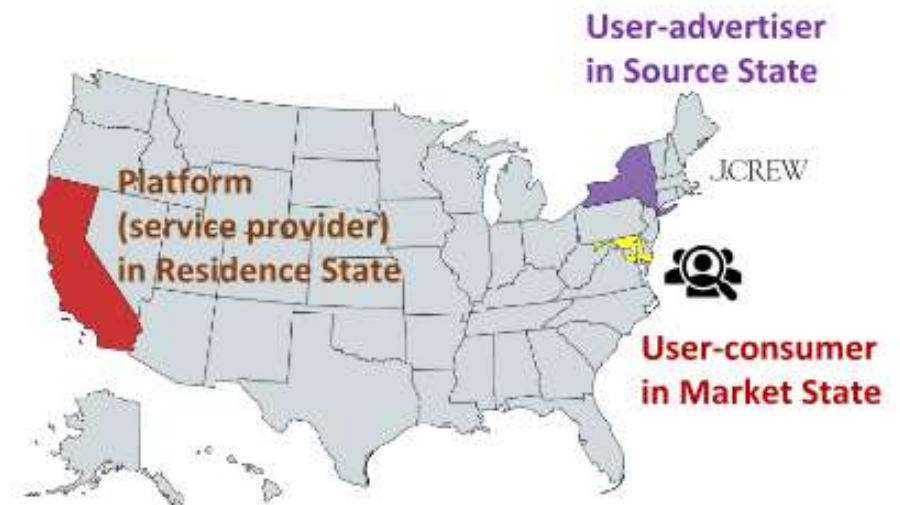
Google Search

I'm Feeling Lucky

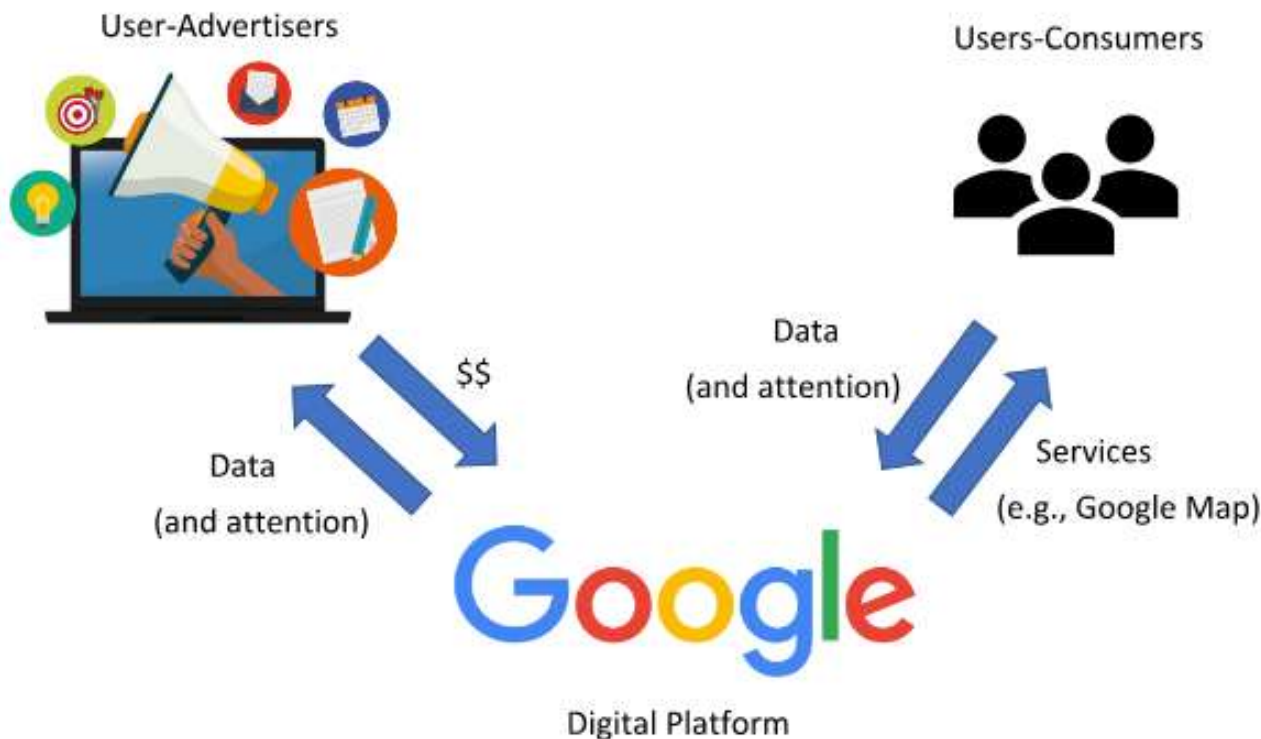
# Distinctive Features of Digital Platforms

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- Different user groups and network effects
- Two-sided market and differing pricing mechanisms
- Zero marginal costs and monopolies
- Tax Challenges



# Tax Problems in the Platform Economy



- If the consumer just bought a physical map, sales tax would be due.
- The products and services that user/ consumers receive generally represent final consumption that should be part of the sales tax base, but there is no cash flow.
- The DAT is treating the cash flow from the advertisers as a proxy for the value of the untaxed services.
- Allows market state to collect revenue from digital platforms.

# Digital Platforms: Three Business Models

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Digital Advertising Platform

Digital Ad Tax

Google



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You Tube

Online Marketplace

Sales Tax  
(post *Wayfair*)

amazon

airbnb

Uber  
lyft

Content Provider

Netflix Tax



Spotify

hulu  
NETFLIX

# Digital Ad Taxes

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The core of a digital ad tax is that the base of the tax is gross receipts from digital ads.

There is typically a threshold (consisting of global revenue and smaller local revenue) that trigger the obligation to collect the tax.

There is a method to source ads to the jurisdiction, typically using the ratio of users or devices in the state.

For recent models, see: LB 388 (NE); HB 2234 (TN); SB 1327 (CA).



# What has happened? (Int'l and federal level)

- Digital Services Tax (DST)
  - Pioneered in Europe



- Global Tax Deal (Oct. 2021)
  - Pillar One: Digital taxation
  - Pillar Two: Global minimum tax (15%)
  - Nearly 140 countries have signed on.
  - Required to repeal DSTs
  - But Pillar One is likely to fail, and DSTs are expected to revive.



# Digital Taxes Are Increasingly Common

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- 12 countries and Maryland have such taxes, and Canada seems to set to join the fun:
  - “Canadian Parliament Approves Controversial Digital Services Tax,” Tax Notes Int’l, June 21, 2024.
  - And note: “Canada's parliamentary budget officer estimated that the DST would increase revenue by C \$7.2 billion over five years.”





## ...and Effective!

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At least in the UK is that the tax raised more revenue for less administrative expense than anticipated.

- “The implementation was smooth, and costs were quite low: His Majesty’s Revenue & Customs (HMRC) implemented the DST for £6.3 million (€7.25 million).
  - Kane Borders et al., EU Tax Observatory, “Digital Service Taxes,” at 13 (June 2023).
- “HMRC collected £358 million for the year 2020–21 (30% more than forecast due to the unpredictable impact of the COVID-19 pandemic), with 90% coming from five business groups. Digital Services Tax is forecast to raise around £3 billion by 2024–25.”
  - <https://publications.parliament.uk/pa/cm5803/cmselect/cmpublicacc/732/report.html>

# Why Digital Taxes are a Good Policy?

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- Fill out the consumption tax
  - Google maps example
  - Gross receipts a proxy for lost sales tax base
- Tax economic rents
  - Monopoly/oligopoly
  - These firms earn supranormal returns (economic rents), and taxing such returns is economically efficient
- Regulatory tax to reduce an externality
  - The business model of the big platforms arguably encourages destructive behavior.
  - Imposing an efficient tax is a foothold to provide effective regulation.
- Increase fairness to consumers
  - Consumers are bartering away their personal information for too low a price

# Legal analysis of DSTs: The case of Maryland

## Internet Tax Freedom Act (ITFA)

- Discrimination against e-commerce?

- Digital Ads are not similar to traditional ads
- To capture untaxed consumption
- Digital ad revenue is a proxy

## Dormant Commerce Clause

- Taxing extraterritorial values?

- Connection b/w the size of the gross revenue, economic rent, and untaxed consumption

## Foreign Affairs Doctrine

- One voice prong
- Foreign affairs preemption

- Executive agreement to bypass treaty ratification
- Is there preemption?

## *Murphy*

- Congress's preemption of state tax law is unconstitutional?

- Wither *Murphy*
- Compare with *Wayfair*

# Internet Tax Freedom Act (ITFA)

- The Internet Tax Freedom Act (ITFA) prohibits “discriminatory taxes on electronic commerce.” Discrimination under the ITFA requires that a tax be imposed on electronic commerce but not on “similar property, goods, services, or information accomplished through other means.”
- Why does similarity matter? Because a tax only injures an industry if a similar tax is not levied on its competitors.

# Are digital ads similar?

- . . . Such that there is a competitive harm?
- I think this is a hard case to make: do traditional ads follow *you* around traditional malls?
- And, really, at least some of the opponents of digital taxes share this intuition.
  - Consider the complaint that taxing digital ads hurts small business, but how can that be unless these business have to use digital ads because so-called traditional ads are not really a substitute?
  - (Note: I don't think the incidence of the tax would likely fall on small businesses.)
- Fun fact: Red Pandas are not actually pandas.

## Also, there is untaxed consumption

- There is a tax imposed on similar consumption (e.g., my purchase of a book of maps) and it is called the sales tax.
- Thus, there is also no discrimination because all states are trying to do is treat all transactions the same and not grant special treatment to digital platforms.



## And finally

- Constitutional values and doctrine push against broad interpretations of the scope of preemption.
  - NY Court of Appeals (citing the US Sup. Ct) in a case involving PL 86-272 (NB re MTC Guidelines):
    - “We will not, ‘absent unambiguous evidence, infer a scope of pre-emption beyond that which clearly is mandated by Congress’ language.”
      - Matter of Disney Enterprises Inc. v. Tax Appeals Tribunal, 888 N.E.2d 1029, 1036 (N.Y. 2008) (quoting Cipollone v. Liggett Group Inc., 505 U.S. 504, 533 (1992)).
  - Alexander Hamilton, Federalist #32:
    - “I affirm that (with the sole exception of duties on imports and exports) [the individual states] would, under the plan of the convention, retain that authority [the power to raise their own revenues] in the most absolute and unqualified sense; and that an attempt on the part of the national government to abridge them in the exercise of it, would be a violent assumption of power, unwarranted by any article or clause of its constitution.”

# The ITFA is a great example of why we should apply this presumption rigorously

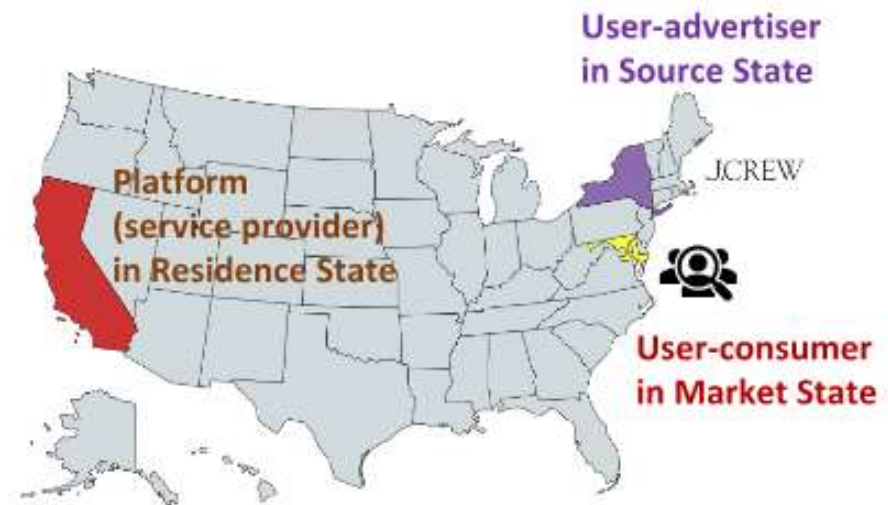
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- Congress has a strong incentive to grant tax cuts to powerful interests that do not cost the federal government anything because Congress is giving away *state* revenue.
- This seems a fair way to characterize the ITFA.
- Of course, the ITFA needs to be given a fair reading, but it's perverse – and contrary to current law - to give these narrow interests any victory beyond what they clearly got out of Congress.

# Responding to policy objections

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- Expand sales taxes/ use corporate income taxes
- Difficulties of taxing barter transactions
- Economic distortion by tax pyramiding
- Regressive tax incidence





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## Conclusion

- Digital Ad Taxes are
  - A different tax used to capture untaxed digital barter transactions in different business models.
  - A method of taxing digital platforms that enjoy supranormal returns while generating social harm.
- State tax policy is always comparative.
  - Raising revenues through a digital ad tax is a relatively good choice in comparison to other choices (though there are excellent other choices, like worldwide combined reporting).
- Next step
  - Online marketplaces
  - Content providers



## *See also*

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Young Ran (Christine) Kim & Darien Shanske, [\*Digital Barter Taxes Are Good Tax Policy \(Part I\)\*](#) 112 TAX NOTES STATE 765 (June 10, 2024)

Young Ran (Christine) Kim & Darien Shanske, [\*Digital Barter Taxes: A Legal Defense \(Part II\)\*](#), 114 TAX NOTES STATE 1787 (June 17, 2024)

Young Ran (Christine) Kim & Darien Shanske, *State Digital Services Taxes: A Good and Permissible Idea (Despite What You Might Have Heard)*, 98 NOTRE DAME L. REV. 741 (2022), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4205398](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4205398)

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# Thank you.

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