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Senator Ann H. Rest, Chair
Senator Matt D. Klein, Vice Chair
Senator Bill Weber, Ranking Minority Member
Taxes Committee
Minnesota State Senate

Re: COST Opposes New Excise Tax on Social Media Businesses – S.F. 3197

Dear Chair Rest, Vice Chair Klein, Ranking Minority Member Weber, and Members of the Committee:

On behalf of the Council On State Taxation (COST), we respectfully submit this testimony opposing the imposition of a monthly excise tax on the collection of data on social platforms, calculated on a per-consumer basis. Rather than fostering a positive business environment, this new untested tax would make Minnesota an outlier, discouraging businesses from seeking to maintain or expand their operations in the State. More importantly, the regulatory and tax aspects of this proposed tax on business inputs violates several principles of sound tax policy – transparency, fairness, economic neutrality, and competitiveness. Additionally, this social media excise tax would impose an additional tax on businesses that are already subject to the State's corporate income tax, it would place an increased administrative burden on both taxpayers and Minnesota Department of Revenue (DOR) and is constitutionally suspect.

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 significant operations in Minnesota and would be negatively impacted by this proposal.

COST Opposes the Taxation of Business Inputs

The COST Board of Directors has adopted the following formal policy positions in opposition to sales taxation of business inputs:

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.¹

[These] ... 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.²

The concerns with the imposition of sales tax on business inputs apply equally to this proposed social media excise tax. The proposed tax in S.F. 3197 is a direct tax on business inputs that violates important tax policy principles, including transparency, fairness, economic neutrality, and competitiveness. Imposing this type of tax on business inputs causes a lack of transparency resulting from pyramiding. Pyramiding of tax occurs when a tax is imposed on multiple intermediate levels, such that the effective (hidden) tax rate on final consumption exceeds the statutory sales tax rate. As a result, companies must either pass these cost increases on to consumers or reduce their economic activity in the State to remain competitive with other producers not subject to the same compliance and economic burdens. For example, the tax on social media will only increase the cost of products sold in the State to recover the imposition of this tax. Many of those products are already subject to the State's sales/use tax. Besides higher prices, some of the cost will inevitably be shifted to labor through lower wages and employment. Additionally, this proposed legislation could inadvertently seriously impact businesses that collect information needed for their ordinary business operations.³

Businesses Subject to the Social Media Excise Tax Are Already Subject to the State's Corporate Income Tax

It is important to note, social media companies that do business in the State are subject to the Minnesota corporate income tax and there is no rational basis for imposing an additional tax based solely on the number of customers a social media business has in the State.⁴ The Minnesota corporate income tax requires mandatory unitary combined reporting using the "Finnigan" method for sales factor representation, effectively giving the State expansive jurisdiction to impose the corporate income tax without requiring a physical presence in the State. As a result, the same businesses subject to this proposed tax are already subject to the State's corporate income tax. Further, Minnesota employs a single sales factor apportionment method that utilizes a market-based sourcing regime for sourcing receipts from services. Market-based sourcing apportions income from services based on where the customer receives the benefits from the service rather than the location of the taxpayer. As a result, Minnesota's

¹ This policy position is available at: www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf.

² This policy position is available at: www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/grossreceiptstaxes.pdf.

³ "Social media platform company" very broadly applies to anyone collecting consumer data and would impact the insurance industry, medical industry, credit industry, retail industry, to name a few.

⁴ The "social media" tax on non-monetized data transactions is based on unsound tax policy. For a critique of the design flaws of similar (unsuccessful) proposals in other states, see: Karl A. Frieden and Douglas L. Lindholm, "A State DAT Relabeled a 'Digital Barter' Tax Is Still Bad Tax Policy," *Tax Notes State*, August 5, 2024; Frieden and Lindholm, "State Digital Services Taxes: A Bad Idea Under Any Theory," *Tax Notes State*, April 10, 2023.

corporate income tax regime already taxes businesses with income derived from Minnesota activities.

Administratively Burdensome

The COST Board of Directors has also adopted a formal policy statement urging states to impose fair, efficient, and customer-focused tax administration. COST's policy 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.⁵

The proposed new and unique social media excise tax violates this tax policy principle because it is a burdensome tax that will require most taxpayers to undertake extensive system changes to collect and remit the proposed tax. Identification of who is a Minnesota "consumer" will not always be readily ascertainable.⁶ This legislation would punitively require businesses collecting data from more than 100,000 Minnesota residents to remit a tax of 10 cents per month per Minnesota resident with the tax increasing to \$165,000 (\$1,980,000 per year) plus 50 cents a month per Minnesota resident on the amount of consumers a social media company has with over 1 million Minnesota residents. The new social media tax will place additional administrative burdens and costs on both the DOR and business.

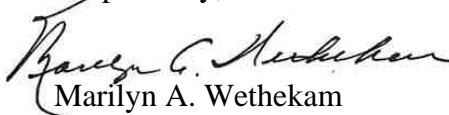
Suspect Constitutionality and Protracted Litigation

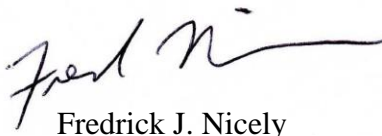
Finally, this legislation is very likely to result in expensive and protracted litigation. Besides litigation over determining who is a Minnesota consumer, the proposed legislation treats all data collection as if it has an equivalent monetary value. This raises serious Due Process and Commerce Clause concerns under the U.S. Constitution.

Conclusion

For the foregoing reasons, COST strongly urges members of the Committee to reject the creation of a social media excise tax.

Respectfully,


Marilyn A. Wethekam


Fredrick J. Nicely

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

⁵ This policy position is available at: 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.

⁶ How many "home addresses" are "known" by a social media platform business is concerning and defaulting to an internet protocol with the growth in virtual private networks (VPN), makes such reliance on such extremely unreasonable. It could artificially encourage VPN activity to take place outside of the State.