



State & Local Tax Advisory ■

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If at First You Don't Succeed, Try, Try Again to Enact the Nation's First Digital Advertising Services Tax

On February 12, 2021, Maryland enacted the “digital advertising gross revenues tax.” Maryland is now the first state in the nation to tax digital advertising services. H.B. 732 was enacted after both chambers of Maryland’s legislature voted to override the governor’s veto.

H.B. 732 will take effect 30 days after the legislature’s override of the governor’s veto, but the tax will be retroactive to the beginning of 2021, applying to all taxable years beginning after December 31, 2020. However, the law is likely to face legal challenges, which may delay the effective date of the tax if an injunction is granted pending the outcome of the litigation. The state expects the tax to generate up to \$250 million in the first full year of implementation.

H.B. 732 will impose a tax on a business’s annual gross revenues derived from “digital advertising services” in the state. Digital advertising services include “advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services.” H.B. 732 defines a “digital interface” as “any type of software, including a website, part of a website, or application, that a user is able to access.” The bill defines a “user” as “an individual or any other person who accesses a digital interface with a device.” The bill does not define “device.”

The tax is imposed on businesses that have (1) “annual gross revenues derived from digital advertising services in [Maryland] of at least \$1,000,000”; and (2) at least \$100 million in global annual gross revenues. H.B. 732’s \$100 million global annual gross revenues threshold is not limited to digital advertising services revenue. Instead, Maryland looks to a company’s revenue from any worldwide source to determine the amount of global annual gross revenues.

H.B. 732 lacks any sourcing provisions for the \$1 million threshold and instead left the state’s comptroller to draft regulations to explain how businesses source digital advertising services to Maryland. The comptroller has yet to release any regulations or offer any guidance. Previous legislation proposing the digital advertising services tax had included provisions that sourced digital advertising services to Maryland if the IP address on a user’s device was located in Maryland or if the comptroller suspected that the user’s device had been used in the state.

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The following rates will apply to the digital advertising services tax:

- 2.5% of the “assessable base” (i.e., annual gross revenues from digital advertising services in Maryland) for a business with global annual gross revenues of \$100 million through \$1 billion.
- 5% of the assessable base for a business with global annual gross revenues of \$1,000,000,001 through \$5 billion.
- 7.5% of the assessable base for a business with global annual gross revenues of \$5,000,000,001 through \$15 billion.
- 10% of the assessable base for a business with global annual gross revenues exceeding \$15 billion.

Now that the legislature has enacted the tax, we expect a flurry of legal challenges under at least three legal theories. Any lawsuit will likely ask a court to declare the digital advertising services tax preempted and unconstitutional and will likely seek a permanent injunction preventing the comptroller from enforcing the tax. The tax is subject to numerous challenges, including:

- The tax violates the Internet Tax Freedom Act (ITFA) because it imposes a “discriminatory tax” on “electronic commerce.” In violating the ITFA, the tax also violates the U.S. Constitution’s Supremacy Clause.
- The tax violates the U.S. Constitution’s Commerce Clause by discriminating against interstate and foreign commerce.
- The tax violates the First Amendment by singling out speech for taxation.

The Maryland legislature has also introduced companion amendments, H.B. 1200 and S.B. 787, though they have not been enacted into law with H.B. 732. If enacted, the amendments would (1) exclude from the tax “advertisement services on digital interfaces owned or operated by or operated on behalf of a broadcast entity or news media entity”; and (2) prevent a business subject to the tax from directly passing along the cost of the tax “to a customer who purchases the digital advertising services by means of a separate fee, surcharge, or line-item.”

Even though challenges to the tax are inevitable, businesses subject to the tax have upcoming compliance deadlines. While the tax applies annually with a return due on or before April 15 of the following year, businesses that expect their digital advertising services revenues to exceed \$1 million must file quarterly estimated tax returns. The first estimated tax return deadline is April 15, 2021. The comptroller has yet to publish any guidance or return forms for the digital advertising services tax.

While H.B. 732 is the nation’s first tax on digital advertising services, it may not be the last. So far, at least five other states, including New York, have introduced legislation during the 2021 legislative calendar to impose a tax on digital advertising services. Like H.B. 732, if any of these bills are enacted or signed into law, they will face legal challenges.

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