



## MULTISTATE INDIRECT TAX

# Maryland enacts tax on digital advertising services

## Tax Alert

### Overview

On February 12, 2021, the Maryland Senate, following the House of Delegates earlier in the week, voted to override the veto of Governor Larry Hogan to House Bill 732, resulting in the enactment of a new gross revenues tax on digital advertising services in Maryland. This tax is the first of its kind.

This Tax Alert summarizes the enactment of House Bill 732, the key aspects of Maryland's new tax on digital advertising services, and the potential constitutional challenges the new tax may face.

### Maryland's digital advertising services tax

#### House Bill 732

Maryland House Bill 732 ("HB 732"), introduced on January 30, 2020, proposed to impose a new tax on taxpayers' gross revenue from digital advertising services in Maryland.<sup>1</sup> The revenues from the tax would be earmarked to fund public education. On March 18, 2020, following passage by the Maryland General Assembly, HB 732 was presented to Governor Larry Hogan. On May 7, 2020, Governor Larry Hogan vetoed HB 732. On February 12, 2021, following the Maryland House of Delegates, the Maryland Senate voted 29-17 to override Governor Larry Hogan's veto.<sup>2</sup> Initially, HB 732 was to become effective July 1, 2020 and apply to all taxable years beginning after December 31, 2020. However, the Maryland Constitution provides that vetoed legislation becomes effective 30 days after a veto override if that date is later than the effective date in the previously vetoed legislation.<sup>3</sup> As the veto override date of February 12, 2021 is later than the effective date of July 1, 2020, HB 732 now becomes effective March 14, 2021 and applies to taxable years beginning after December 31, 2020.

#### Key aspects of Maryland's new tax

- The newly enacted tax law defines digital advertising services to 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.” Digital Interface means, “any type of software, including a website, part of a website, or application, that a user is able to access.”<sup>4</sup>

- The tax rate ranges from 2.5% to 10% and applies to the taxpayer’s global annual gross revenue from digital advertising services in Maryland.
- In order to be subject to the tax a taxpayer must have \$100,000,000 in global annual gross revenue and \$1,000,000 of Maryland annual gross revenue from digital advertising services in Maryland.
- The tax is applied on a calendar year basis with quarterly estimated payments of at least 25% of the estimated tax base due in April, June, September, and December each year and an annual tax return due by April 15th of the following year.
- A penalty of up to 25% may be imposed on underestimated quarterly payments. Also, taxpayers may be subject to criminal penalties for the willful failure to file a return.

### Potential challenges

Maryland’s newly enacted digital advertising services tax may face multiple challenges ranging from the validity of the tax to its implementation. As also noted by commentators and others,<sup>5</sup> Maryland’s new tax on digital advertising service revenues has been opposed by a number of organizations and industry groups on several grounds, including: (i) that the tax is unconstitutional on Due Process and Commerce Clause grounds, and (ii) that the tax violates the permanent Internet Tax Freedom Act as a “discriminatory tax[] on electronic commerce.”<sup>6</sup>

The new tax may also pose implementation challenges to the Maryland Comptroller of the Treasury and taxpayers, such as how the tax is administered, reported, and audited. As such, the Maryland General Assembly is considering proposed supplemental legislation clarifying that the tax does not apply to radio and television broadcasters and news media companies and that the cost cannot be directly passed along to businesses that buy advertisements as a separately stated charge.<sup>7</sup>

While Maryland’s digital advertising services tax is a novel approach and may face multiple challenges, it could be the start of a trend for states seeking to expand and modernize their tax bases. For example, Connecticut<sup>8</sup> has introduced similar legislation this year and Washington<sup>9</sup> and other states may be considering similar legislation. Also New York has recently attempted to enact taxes on tech companies, but such efforts thus far have failed.<sup>10</sup>

### Considerations

As Maryland’s digital advertising services tax applies to taxable years after December 31, 2020, potentially affected taxpayers should evaluate whether a declaration of estimated tax may be due April 15, 2021, bearing in the mind the risk of potential criminal penalties for lack of compliance.

### Get in touch

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## Footnotes

- <sup>1</sup> H.B. 732, Gen. Assemb., 2020 Reg. Sess. (Md. 2020), available at <http://mgaleg.maryland.gov/mgawebsite/Legislation/Details/HB0732/?ys=2020rs>.
- <sup>2</sup> *Id.*; see also <http://mgaleg.maryland.gov/mgawebsite/FloorActions/Media/senate-11-A?year=2021rs>.
- <sup>3</sup> Md. Const. art. II, § 17(d).
- <sup>4</sup> H.B. 732, Gen. Assemb., 2020 Reg. Sess. (Md. 2020), available at <http://mgaleg.maryland.gov/2020RS/bills/hb/hb0732E.pdf>.
- <sup>5</sup> See, e.g., The Marylanders for Tax Fairness Coalition which is made up of more than 200 businesses that are against Maryland's digital advertising tax, available at, <https://www.marylandtaxfairness.org/coalition-members-list/>; see also, Michael J. Semes & Jared Walczak, *Maryland's Digital Advertising Tax is Unworkably Vague*, The Tax Foundation (Feb. 2021).
- <sup>6</sup> Internet Tax Freedom Act, P.L. 105-277, 112 Stat. 2681.
- <sup>7</sup> S.B. 787, Gen. Assemb., 2021 Reg. Sess. (Md. 2021), available at <https://mgaleg.maryland.gov/2021RS/bills/sb/sb0787F.pdf>.
- <sup>8</sup> H.B. 5645, Gen. Assemb., 2021 Reg. Sess. (Conn. 2021), available at <https://www.cga.ct.gov/2019/TOB/h/pdf/2019HB-05645-R00-HB.PDF>.
- <sup>9</sup> Paul Jones, *Lawmakers May Consider Digital Ad Tax in 2021*, 98 Tax Notes 996 (Nov. 30, 2020).
- <sup>10</sup> See S. 8056, 2020 Leg., Reg. Sess. (N.Y. 2020); see also S. 1124, 2021 Leg., Reg. Sess. (N.Y. 2021).

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