

# Maryland Passes Digital Advertising Tax

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## The Bottom Line

- *Businesses that may have revenue “derived from” digital advertising should consult with their tax advisors concerning forthcoming changes in the law, regulations, and legal challenges to see how Maryland’s digital advertising tax and potential imitators may affect them.*
- *Because of uncertainties in the law, the scope and application of Maryland’s new digital advertising tax is uncertain.*

After more than a year of contention, Maryland’s proposed digital advertising services tax has become law (the Act). On February 12, 2021 the Maryland Senate voted to override Governor Hogan’s previous veto of the legislation. The Act requires “persons” to pay a tax at rates between 2.5 percent and 10 percent on “annual gross revenues [of such person] derived from digital advertising in the state [of Maryland].” However, due to vague drafting, who must pay — and how much — remains uncertain in many cases.

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## Digital Advertising Services Tax

The definition of “digital advertising services” is open-ended. The Act provides only that it “includes” (but presumably is not limited to) “advertisement services on a digital interface” meaning “any type of software, including a website,” including “banner advertisements and also search engine advertising, interstitial advertising, and other comparable advertising services.”

How far this definition could extend beyond the items it “includes” is not clear.

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## Tax Rates

The Act imposes tax at an escalating rate between 2.5 percent and 10 percent on the gross revenue of businesses from “digital advertising services” conducted in Maryland.

Key things to note are:

- The 2.5 percent rate is imposed on businesses with at least \$100 million in global gross revenue (from all sources, digital advertising or not, in or outside Maryland).
  - This increases in four increments to a maximum rate of 10 percent for businesses with annual global gross revenues of \$15 billion or more.
  - The tax is assessed annually on all businesses whose revenue from digital advertising services in Maryland exceeds \$1 million.
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## The Meaning of “in Maryland”

The Act provides no detail on how “gross revenue” is to be deemed arising “in Maryland,” something extremely hard to gauge in the context of worldwide digital platforms.

The Act merely states that “the part of the annual gross revenues of a person derived from digital advertising services in the state shall be determined using an apportionment fraction,” of which the numerator is the advertising services derived in Maryland and the denominator is the digital advertising revenues in the United States. This fraction leaves unanswered what is “derived” in Maryland.

It should be noted that though the base appears to be worldwide gross revenues, the apportionment fraction is based solely on advertising revenues in the United States, which, itself, could lead to distortions.

The Act directs the Maryland Comptroller to issue more detailed rules about how this apportionment ratio should be applied.

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## **“Derived From Digital Advertising Services”**

Further, the law is vague as to what it means for revenue to be “derived from” digital advertising services, and it is unclear whether the fees paid to advertising brokers, advertising companies, designers, agents, and other intermediaries may be subject to the tax.

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## **Potential Multiple Taxation**

Since the Act creates a new, separate tax, it does not have the familiar “sale for resale” exemption incorporated in state sales tax regimes to prevent multiple taxation of the same item passing through a chain of resellers to the ultimate customer. Accordingly, it is possible that the Act might result in tax being assessed multiple times for the same overall transaction.

For example, consider a Maryland advertiser paying a fee to an advertising company to place its advertisement on an online platform. They could theoretically impose tax on both the payment to the advertising company and to the online platform, with no credit to either the ad company or the platform for the tax paid by the other (or even knowledge by each whether the other has paid the tax).

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## **Legal Uncertainty**

Legal challenges are all but certain. In its review of the proposed bill, the Maryland Attorney General's Office did not find the Act to be clearly unconstitutional, but nevertheless highlighted three grounds on which a reviewing court could find the tax void:

- Preemption by the federal Internet Tax Freedom Act because that act prohibits states from imposing “multiple and discriminatory taxes on electronic commerce;”
- The Commerce Clause of the U.S. Constitution by potentially penalizing and interfering with out-of-state commerce and disproportionately penalizing out-of-state taxpayers; and
- The First Amendment of the U.S. Constitution by potentially infringing freedom of speech.

The first lawsuit challenging the Act has already been filed in the U.S. District Court of Maryland. With state budgets suffering from the effects of the global pandemic and ever increasing opportunities for citizens to view digital advertisements, many states (including New York, Connecticut, and Montana, which have considered similar bills) and businesses will be watching the fate of the Act with great interest. If it survives legal challenges, it may be only the beginning of state taxes to come.

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