

Department of Legislative Services  
Maryland General Assembly  
2020 Session

FISCAL AND POLICY NOTE  
First Reader

House Bill 695 (Delegate Washington)  
Ways and Means

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Digital Advertising Gross Revenues - Taxation

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This bill imposes a tax on the gross revenues of specified digital advertising. After making deductions for the administration of the tax, the Comptroller is required to deposit the revenues received from the tax to the Blueprint for Maryland's Future Fund. The bill provides for the filing of the tax returns and making tax payments. **The bill takes effect July 1, 2020, and applies to taxable years beginning after December 31, 2020.**

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Fiscal Summary

**State Effect:** Special fund revenues may increase by a significant amount beginning in FY 2021. Special fund expenditures increase by \$1.6 million in FY 2021 and by \$731,300 in FY 2025. Future year expenditures reflect annualization and inflation.

**Local Effect:** None.

**Small Business Effect:** Minimal.

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Analysis

**Bill Summary:**

*Digital Advertising Gross Revenues Tax*

The bill imposes a tax on the annual gross revenues of a person derived from digital advertising services in the State. Digital advertising services are provided in the State if the digital advertising services appear on the device of a user with an Internet Protocol (IP)

address that indicates that the user's device is located in the State or who is known or reasonably suspected to be using the device in the State.

The digital advertising gross revenues tax is imposed at the following rates:

- 2.5% of the assessable base for a person with global annual gross revenues of \$100.0 million through \$1.0 billion;
- 5% of the assessable base for a person with global annual gross revenues of \$1.0 billion through \$5.0 billion;
- 7.5% of the assessable base for a person with global annual gross revenues of \$5.0 billion through \$15.0 billion; and
- 10% of the assessable base for a person with global annual gross revenues exceeding \$15.0 billion.

Revenues from the digital advertising gross revenues tax are distributed to the Blueprint for Maryland's Future Fund, after the Comptroller's costs to administer the tax are deducted.

### *Tax Returns*

Each person that has annual gross revenues derived from digital advertising services in the State of at least \$1.0 million in a calendar year must complete, under oath, and file a return with the Comptroller on or before April 15 the next year.

Each person that reasonably expects annual gross revenues derived from digital advertising services in the State to exceed \$1.0 million must complete, under oath, and file with the Comptroller a declaration of estimated tax, on or before April 15 of that year.

A person required to file a declaration of estimated tax for a taxable year must complete and file a quarterly estimated tax return on or before June 15, September 15, and December 15 of that year.

A person required to file a return must include an attachment with the return that states any information that the Comptroller requires to determine annual gross revenues derived from digital advertising services in the State. A person must maintain records of digital advertising services provided in the State and the basis for the calculation of the digital advertising gross revenues tax owed.

### *Payment of Digital Advertising Gross Revenues Tax*

Each person required to file a return must pay the digital advertising gross revenues tax with the return that covers the period for which the tax is due. A person filing an estimated digital advertising gross revenues tax return must pay (1) at least 25% of the estimated digital advertising gross revenues tax shown on the declaration or amended declaration for a taxable year with the declaration or amended declaration that covers the year and with each quarterly return for that year and (2) any unpaid digital advertising gross revenues tax for the year shown on the person's return.

### *Penalties*

A person who willfully fails to file a digital advertising gross revenues tax return is guilty of a misdemeanor and, on conviction, is subject to a fine of up to \$5,000 and/or imprisonment of up to five years.

### *Definitions*

Annual gross revenues are defined as income or revenue from all sources, before any expenses or taxes, computed according to generally accepted accounting principles.

Assessable base is defined as the annual gross revenues derived from digital advertising services in the State.

Digital advertising services includes 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 is defined as any type of software, including a website, part of a website, or application, that a user is able to access. A user is an individual or any other person who accesses a digital interface with a device.

**Background:** Generally, a digital advertising gross revenues tax proposes to tax the gross online advertising revenues of large multinational corporations, such as Alphabet/Google, Amazon, Facebook, and others that have a large presence in digital advertising. Several European countries have proposed or implemented laws to tax digital services including advertising. Great Britain, Italy, Spain, and Turkey are among the countries that have proposed a tax, while only France and Hungary have implemented such a tax. The European Union considered a proposal to impose a tax on digital advertising, but a final agreement was not reached.

Maryland is the first state in the country to introduce legislation imposing a tax on digital advertising. Legislation in Nebraska has been introduced (LB 989) expanding the state's sales tax to include digital advertising.

Proponents of a digital advertising or digital services tax argue that many digital companies are undertaxed or are not paying their fair share of taxes. It is argued that some digital companies are able to reduce taxable assets through a number of mechanisms, such as assigning ownership of income producing sources to affiliates in low tax jurisdictions. As such, a digital advertising tax could be considered a type of tax on corporate profits in the digital economy.

Opponents of this type of tax cite potential conflicts with existing law. The federal Internet Tax Freedom Act includes a prohibition on state and local governments from taxing Internet access and from imposing multiple and discriminatory taxes on electronic commerce. In addition, as the tax will be assessed on global revenues, it may lead to large multinational businesses having a higher tax burden in Maryland than Maryland-only providers. This could lead to challenges that the tax violates the Commerce Clause of the U.S. Constitution, which prohibits state laws that interfere with interstate commerce.

It should also be noted that past efforts to impose taxes on the news media or advertising revenues have been rejected by the U.S. Supreme Court on First Amendment grounds. In addition, the Maryland Court of Appeals ruled in 1958 that a 4% sales tax on television, newspaper, and radio advertising that was proposed by Baltimore City was an unconstitutional violation of the First Amendment.

### *The Blueprint for Maryland's Future*

The Blueprint for Maryland's Future Fund is a special nonlapsing fund that may be used only to assist in providing adequate funding for early childhood education and primary and secondary education based on the recommendations of the Commission on Innovation and Excellence in Education, including revised education funding formulas. Chapter 771 of 2019 established in statute the policy framework for a world-class education system in Maryland based on the commission's recommendations. When fully phased-in, the commission's recommendations are expected to require an additional \$2.8 billion in State funding and \$1.2 billion in local funding by fiscal 2030.

**State Revenues:** The bill requires businesses that have at least \$100.0 million in global annual gross revenues to pay a tax on gross revenues derived from digital advertising in the State. After a deduction for administrative costs for the Comptroller's Office, revenue from the tax is distributed to the Blueprint for Maryland's Future Fund. As a result, State special fund revenue may increase by a significant amount beginning in fiscal 2021.

Under one set of assumptions, special fund revenues could increase by as much as \$250.0 million in the first full year that the tax is imposed and collected. The assumptions used in the estimate are outlined below:

- Maryland represents 1.84% of the total U.S. population;
- digital advertising revenues in the United States totaled \$107.5 billion in 2018 and \$57.9 billion in the first half of 2019, according to the Interactive Advertising Bureau;
- approximately 90% of large companies that receive digital advertising revenues have global revenues over \$15.0 billion and almost 8.0% have global revenues of between \$100.0 million and \$5.0 billion (according to industry source eMarketer); and
- digital advertising revenues increased by 21.8% from 2017 to 2018 and by 16.7% in the first half of 2019 compared to the first half of 2018.

However, there are two factors that may significantly impact the amount of tax revenue the State collects, particularly in the short term: (1) litigation and (2) compliance issues.

#### *Potential Litigation*

As previously mentioned, the imposition of the tax could face legal challenges on several fronts. While it is not possible to determine when potential legal challenges may arise, and how long they would take to resolve, this could limit the amount of any revenues collected from the tax while litigation is pending.

#### *Potential Compliance Issues*

In order to determine the amount of gross advertising revenues in Maryland, companies will have to track user IP addresses to determine whether they are in Maryland when they are viewing an advertisement. This could pose problems when a user is near or crossing the State border while receiving an advertisement on a mobile device, or using a virtual private network to alter their location. This could make tax compliance more difficult.

Also, the Comptroller's Office advises that it may not be able to assess or enforce the tax owed by a foreign company that meets the gross revenue threshold and who has Maryland users but does not pay any taxes in the United States.

**State Expenditures:** The bill requires the Comptroller to distribute funds necessary to administer the digital advertising gross revenues tax to an administrative cost account. As a result, special fund expenditures increase by \$1.6 million in fiscal 2021. Future year expenditures increase by \$667,500 in fiscal 2022 and by \$731,300 in fiscal 2025.

The Comptroller’s Office advises that it is currently in the process of implementing a new tax system named Compass. However, due to the bill’s effective date, the computer mechanisms needed to administer the new tax proposed by the bill, such as creating forms and processing returns and payments, will have to be done on the current Legacy tax system as well as the new Compass system. In addition, the Comptroller’s Office will need additional personnel to administer the tax, which includes identifying businesses subject to the tax, processing returns and payments, auditing returns and payments, enforcing compliance, and handling expected litigation.

This estimate reflects the cost of hiring one assistant Attorney General, two administrative officers, two tax consultants, three revenue specialists, and one financial compliance auditor to administer the new tax. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses and computer programming and modification charges.

Position(s)	9
Salaries and Fringe Benefits	\$343,237
Computer Programming and Modification	1,250,000
Operating Expenses	46,868
<b>Total FY 2021 State Expenditures</b>	<b>\$1,640,105</b>

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

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### **Additional Information**

**Prior Introductions:** None.

**Designated Cross File:** SB 2 (Senators Miller and Ferguson) - Budget and Taxation.

**Information Source(s):** Comptroller’s Office; Congressional Research Service; Interactive Advertising Bureau; eMarketer; Department of Legislative Services

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