



American Advertising Federation of Baltimore
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WRITTEN TESTIMONY – JANUARY 29, 2020

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To:

Senate President Bill Ferguson, SB 2 Co-Sponsor
Senator Thomas V. Mike Miller, Jr., SB 2 Co-Sponsor
Senator Guy Guzzone, Chair, Budget and Taxation Committee
Senator Jim Rosapepe, Vice Chair, Budget and Taxation Committee
Members of the Budget and Taxation Committee

Re: Senate Bill 2 – Tax on Digital Advertising

Dear Senate President Ferguson, Senator Miller, and Members of the Budget and Taxation Committee:

On Wednesday January 8, 2020, former Senate President Thomas V. Mike Miller Jr. and current Senate President William “Bill” Ferguson sponsored Senate Bill 2 (“SB 2”), titled “Digital Advertising Gross Revenues – Taxation.” SB 2 intends to impose:

a tax on annual gross revenues derived from digital advertising services including advertisement services on a digital interface in the State; establishing a presumption that digital advertising services are provided in the State if the digital advertising services appear on a certain device of a certain user; requiring the Comptroller to distribute digital advertising gross revenues tax revenue to

administer certain tax laws and the remainder to be distributed to The Blueprint for Maryland's Future Fund; etc.

In my 1/15/2020 letter (APPENDIX I), I outlined the legal and policy concerns of the American Advertising Federation of Baltimore, AAF National, the Digital Goods and Services Coalition, and many other associations in the region and beyond.

In this testimony, I intend to share the possible **impact the passage of this bill could have on agency clients** in Maryland as well as **provide some clarity on what digital advertising entails** to help the committee better understand the far-reaching consequences of moving forward with a bill that fails to clearly articulate that definition.

To understand the impact of the bill, we need a clearer definition of what “revenue derived from digital advertising” is. And we can’t do that unless we have a clearer understanding of what “digital advertising” is. The National Law Review outlines the problematic nature of a broad definition (APPENDIX II)

I can help with the second part. Digital advertising is more than a web banner or search ad. It’s a radio spot on Spotify. It’s video that runs on a local TV station’s website. It’s a website. It’s a podcast. It’s a sales call over VOIP. It’s an email coupon. It’s an Amazon listing. It’s an influencer’s Instagram feed. It’s a job posting on LinkedIn. It’s an internet-connected billboard. It’s the tweet from a political candidate’s campaign.

Outside of revenue thresholds, the bill fails to tell us who actually picks up the tab at tax time:

Is it the platform that serves ads, such as Google or Facebook
Or the publisher that sells ad space, such as the Baltimore Sun
Or company that buys ads, such as Under Armour
or even the agency that creates and manages ads, like idfive. My agency.

idfive primarily serves not-for-profit organizations. Much of the work we do for them falls under digital advertising. Our clients are donor and taxpayer-funded organizations. And digital advertising is often the most affordable, measurable way for them to reach their audiences. For example, Google search ads help the Maryland Food Bank raise funds to feed 100,000 people a day. Sponsored Facebook posts help the Maryland SPCA and BARCS find homes for thousands of homeless animals every year. And YouTube, Google and Facebook help the Baltimore Police Department stretch its finite recruitment dollars to attract new officers at a time when the city needs them most.

While these organizations may not pay the tax directly, make no mistake: They will pay. Any tax levied against a Google or a Facebook, will ultimately be passed down to the organizations who buy media from them.

Maryland's ad industry helps generate more than \$100B in economic activity (APPENDIX III). Additional interpretations of the bill could lead to seismic side effects including:

Competitive Disadvantage:

As written, Senate Bill 2 could create a competitive disadvantage for many local companies from publishers to retailers to advertising agencies. Many organizations in our region that my agency, idfive, serves fall within the \$100 million gross global revenue threshold. This bill could require them to **pay the digital advertising tax on top of the state income they earn on that tax** — a double-tax their out-of-state competitors may not have to pay. Similar efforts in other states have all been struck down because of their net-negative economic impact or because federal courts found them to be unconstitutional. Additional analysis (APPENDIX IV) from the Tax Foundation provides further detail into how a digital tax impacts competitiveness.

Administrative Burden:

Our small agency has five people who manage advertising attribution for a couple of dozen clients. Multiply that by the hundred or so large, midsize, and small full-service agencies in Central Maryland and the DC suburbs and we're looking at an administrative nightmare for the Comptroller's office.

Funding Inconsistency:

Also, expect revenues to shrink significantly over the next couple of years. There's already been a tremendous drop in [mobile location accuracy](#), not to mention the world's most popular browser, Chrome, intends to [phase out 3rd party cookies](#) — a key tracking vehicle for attribution. It may be good news for privacy hawks. But it will further complicate auditors' attempts to reconcile revenue from digital advertising in Maryland.

This bill intends to snipe global media behemoths for quick cash. Instead, it waves a bazooka in their general direction, leaving any organization that advertises in the region at risk of becoming collateral damage. On behalf of the members of the American Advertising Federation of Baltimore, and on behalf of my agency, I urge the Maryland Senate to dismiss S.B. 2.

APPENDIX I – 1/25/2020 Letter to Budget & Taxation Committee Opposing SB 2

January 15, 2020

Senate President Bill Ferguson, SB 2 Co-Sponsor
Senator Thomas V. Mike Miller, Jr., SB 2 Co-Sponsor
Senator Guy Guzzone, Chair, Budget and Taxation Committee
Senator Jim Rosapepe, Vice Chair, Budget and Taxation Committee
Members of the Budget and Taxation Committee

Re: Opposition to SB 2 – Tax on Digital Advertising

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The American Advertising Federation of Baltimore, in partnership with AAF National, have strong concerns regarding the imposition of taxes on digital advertising services as proposed in SB 2. Briefly, the proposed tax is a gross receipts tax. The Digital Goods and Services Coalition has provided the following analysis and predictions of issues that this proposed tax:

Introduction/Background

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- **Uncharted New Tax on Digital Advertising Services:** If enacted by SB 2, Maryland would become the first state or locality in the United States to impose a targeted punitive tax on the gross revenue of digital advertising services. While no state taxes advertising revenue in the manner and extent proposed by SB 2 (primarily due to the constitutional and policy concerns outlined below), only two states tax advertising services under their generally applicable broad-based transaction tax (not a gross receipts tax such as the tax proposed by SB 2). Contradicting the clear legislative trend in the advertising space to exempt the facilitation of advertising services (but tax the consumer transactions that may result therefrom), SB 2 would impose a new one-of-a-kind tax on the annual gross revenue of digital advertising services that are deemed to be provided in the State. The proposed tax contains a tiered tax rate structure (arbitrarily determined based on the advertising

service provider's *global* annual gross revenues) that would allow for up to a whopping tax of 10% of the annual gross revenue in the State derived from digital advertising services. As introduced, SB 2 would take effect July 1, 2020 and apply to all taxable years beginning after December 31, 2020.

Constitutional Concerns

- **Violates Federal Law:** The Permanent Internet Tax Freedom Act (“PITFA”) enacted by Congress prohibits states from imposing “discriminatory taxes on electronic commerce.” See 47 U.S.C. § 151, *note*. The federal law defines “discriminatory tax” as “any tax imposed by a State . . . on electronic commerce that (i) is not generally imposed and legally collectible by such State . . . on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State . . . on transactions involving similar property, goods, services, or information accomplished through other means . . . [or] (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.” *Id.* at § 1105(2)(A). The digital advertising tax proposed by SB 2 would result in a prohibited discriminatory tax on electronic commerce in violation of PITFA. For example, the new digital advertising services tax created by SB 2 would discriminate against digital advertising service providers because Maryland does not also tax service providers of non-digital advertising. Even if similar advertising services are alleged to be subject to the Maryland sales tax, differences in rate or incidence of the tax would independently still result in a “discriminatory tax” in violation of federal law. Because the digital advertising service tax proposal is predominantly imposed on remote advertisers that are implicated due to the ability of an end user to access the advertising material located on the company’s out-of-State server, this provides a separate independent basis to show that the digital advertising service tax is a “discriminatory tax” prohibited by federal law. These are just a few discrete examples of the potential PITFA violations created by SB 2. Because PITFA is a federal law, it must be respected by Maryland under the Supremacy Clause of the U.S. Constitution and if Maryland were to move forward with SB 2 it would likely be struck down by the federal courts—after costly and unnecessary litigation. In the long term, the enactment of this law would not create a stable revenue stream to bolster Maryland education funding and would potentially result in a net loss to the state coffers.
- **Discriminates Against Interstate and Foreign Commerce:** SB 2 would impose the punitive digital advertising gross revenues tax only on large companies based on an arbitrary threshold of *global* annual gross revenues. The larger and more global the company, the higher the tax rate. While this may be politically popular—taxing out-of-state and foreign companies more heavily than in-state businesses is constitutionally suspect under the dormant Commerce Clause. A long history of federal cases have struck down efforts by states and local governments to use extraterritorial receipts to discriminate against interstate businesses and in favor of hometown businesses. This is exactly what the digital advertising gross revenues tax proposed to do – by taxing larger global advertising service providers at a higher tax rate than their domestic counterparts with the exact same gross revenue attributable to Maryland. The Commerce Clause of the U.S. Constitution protects companies from taxes such as the SB 2 digital advertising gross revenues tax and is yet another example of the ripeness of litigation should the tax proposal advance without a substantial

overhaul. These constitutional limitations do not appear to have been considered and collection of the proposed tax could once again put Maryland in the position of having to refund an illegal tax—a process it went through recently when one of its taxes was declared unconstitutional by the U.S. Supreme Court.

- **Additional Constitutional Concerns:** The punitive digital advertising gross revenues tax doesn't stop there in terms of potential constitutional oversteps. For example, the digital advertising gross revenues tax may violate the Equal Protection Clause of the U.S. Constitution due to a lack of a rational basis for discriminating against advertising services provided on a digital interface—since the law does not impose the same punitive treatment on advertising services that are not on a digital interface. The proposed digital advertising service gross revenue tax also raises significant First Amendment concerns due to the fact that the tax would in effect regulate commercial speech by forcing just *digital* advertising service providers in Maryland to either cease allowing Maryland customers to view ads or substantially increase fees they charge companies advertising on their platform against their will (to account for the loss they would otherwise obtain from the punitive digital advertising services tax). For example, the Maryland Court of Appeals has held that municipal taxes on advertising media were unconstitutional for singling out for taxation newspapers and radio and television stations entitled to first amendment immunities. See *City of Baltimore v. A.S. Abell Co.*, 218 Md. 273, 145 A.2d 111 (1958). The same constitutional concerns that the court found in that case apply here—just in the context of digital advertising.

Policy Concerns

- **New Tax Will Hurt Maryland Companies and Residents:** The economic burden of this broad new tax will fall on Maryland residents and Maryland businesses that are consumers of advertising services within a digital interface—including websites and applications. This is because advertising service providers may (and most likely would) pass the tax through to their customers (including local Maryland brick and mortar businesses seeking to reach new customers online), who will be forced to pay higher prices, receive lower revenues, or find cheaper alternatives. While on the surface the tax appears to fall only on large non-resident Internet advertising providers, this new tax initially will fall on Maryland advertisers through increased prices of up to 10% on Internet-based advertising. Eventually, the tax will fall on Maryland consumers who will suffer higher prices for goods and services they purchase from the companies advertising on the digital interface.
- **Similar Proposals Have Failed Historically:** Arizona, Iowa, and Florida each passed broad advertising taxes years ago. Each state later repealed the tax because it hurt their local economy and was impossible to administer. Since 1987, when the Florida services tax was repealed, broad advertising taxes have been considered in more than 40 states and rejected in every instance.
- **Pyramiding and Multiple Taxation Would Result:** Pyramiding occurs when a tax is imposed on business services at the intermediate level, rather than being imposed only on final purchase of the product by consumers (as a sales and use tax is). Advertising is not an end product. Rather, advertising is a communications process that helps produce the final sale of a product, which is most likely already subject to the state sales tax. Since a portion of any tax on the intermediate

advertising process is likely to be passed along to consumers, there would be at least double taxation for most products or services purchased in the state if SB 2 is enacted.

- **Costly to Administer:** An advertising tax such as the tax proposed by SB 2 would create a huge new administrative burden on state government. Digital advertising is a very complex area, involving millions of ads placed across a litany of digital platforms. The Comptroller would likely need to hire new staff and engage an army of accountants and lawyers to administer and enforce the proposed new tax.

Based on the concerns we've outlined, the undersigned strongly oppose SB 2 and ask the Budget and Taxation committee to remove the bill from further consideration. We appreciate your attention to this matter and look forward to exploring ways in which our industry can support Maryland without crippling our competitive and economic prospects.

Best regards,

Matthew McDermott, President, AAF Baltimore;
The Board of Directors, AAF Baltimore;
The Members of the American Advertising Federation of Baltimore; and
Clark Rector, Executive Vice President-Government Affairs, American Advertising Federation

APPENDIX II – Analysis from the National Law Review

BREAKING NEWS: Maryland Proposes (French) Tax on Advertising – Digital Platforms and Advertisers Beware!

by Stephen P. Kranz

Friday, January 10, 2020

<https://www.natlawreview.com/article/breaking-news-maryland-proposes-french-tax-advertising-digital-platforms-and>, Accessed 1.16.2020

On January 8, SB 2 was introduced to establish a new digital advertising gross revenue tax of up to 10% on “annual gross revenues of a person derived from digital advertising services in the state.” This uncharted new tax would make Maryland the first state or locality in the United States to impose a targeted tax on the gross revenue of digital advertising services.

The bill defines “in the state” as appearing on the user’s device located in the state (determined based on either the user’s IP address or reasonable knowledge). “Digital advertising services” is defined as “advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services.” The definition uses the word “includes” rather than “means,” enabling the definition to be read even more broadly. “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.”

The tax applies at a sliding scale:

2.5% for person with global annual gross revenues of \$100 million or more

5% for person with global annual gross revenues of \$1 billion or more

7.5% for person with global annual gross revenues of \$5 billion or more

10% for person with global annual gross revenues of \$15 billion or more

The bill would require quarterly estimated tax payments and an annual return and provides that willful failure to file a digital advertising gross revenues tax return is a misdemeanor subject to a \$5,000 fine and 5 years’ imprisonment.

The bill is co-sponsored by Senator Thomas Miller (D), the outgoing Senate President, and Senator William Ferguson (D), the incoming Senate President. Maryland legislative leaders have been hinting at new taxes on the digital economy, digital downloads, and streaming subscriptions as they decide how to fund a proposed \$825 million per year education spending increase. Governor Hogan (R) opposes the education spending increase as too expensive, amounting to a \$6,000 per family tax increase, and in response Democrats last week ruled out raising income, sales, or property tax rates. We therefore may see additional digital taxation bills aside from this one.

Because Maryland would tax digital advertising but not tax non-digital advertising, the tax is a “discriminatory tax” prohibited by the Permanent Internet Tax Freedom Act (PITFA). The use of an arbitrary threshold of global annual gross revenues, while perhaps politically popular, serves to tax larger global advertising service providers at a higher tax rate than their domestic counterparts, in violation of the Commerce Clause of the US Constitution. The proposal also raises serious First Amendment (singling out digital commercial speech for a punitive tax) and Equal Protection (lack of rational basis for punitive tax on digital advertising) issues.

APPENDIX III – 2019 Impact of Advertising in Maryland from *IHS Economics and Country Risk Research*



Advertising is a powerful engine that helps drive the economy of Maryland. Advertising expenditures account for \$101.5 billion of economic output or sales in Maryland – that is 14.6% of the \$693.1 billion in total economic output in the State. Sales of products and services that are driven by advertising help support 393,667 jobs, representing 14.9% of the 2.6 million jobs in Maryland.

Every million dollars spent on advertising in Maryland supports 82 jobs across industries throughout the state. Every direct advertising job also supported 33 other jobs across all industries. Each form of advertising, from print media and radio and television to the Internet, helps businesses efficiently communicate the benefits of their products and services to target audiences.

This profile illustrates the importance of advertising to the economy of Maryland. It is drawn from the latest research in a landmark series of studies prepared for The Advertising Coalition by IHS Economics and Country Risk. IHS uses methodologies developed by Dr. Lawrence R. Klein, recipient of the 1980 Nobel Prize for Economics, as the foundation for this research.

The IHS research measures the impact of advertising spending by quantifying how much the spending stimulates sales, employment, value-added (contribution to GDP), taxes, and labor income. For example, while

the agriculture and mining industries may have few direct advertising jobs, their combined economic sectors support many industries that do advertise heavily.

Maryland's economy and the U.S. economy are heavily affected by the health of the consumer sector. The consumer sector represents 68% of the U.S. economy and it continues to expand. For example, while the agriculture industry does little advertising, the food, manufacturing, and retail industries advertise heavily across the country. This creates consumer demand for a chain of products and services from sales of farm machinery to the shipment of agricultural products.

U.S. advertisers in 2014 spent \$297 billion on advertising to stimulate consumer demand, and that spending launched a "multiplier effect" throughout the economy. Total advertising expenditures drove \$5.8 trillion in total sales. This represents 16% of the \$36.7 trillion in total U.S. sales attributable to advertising and means that every dollar of ad spending stimulates almost \$19 in sales activity. Just as significant, the total impact of advertising on the U.S. economy represents 19% of U.S. GDP. Every million dollars that is spent on advertising supports 67 American jobs across a range of industries, and every advertising job supports 34 jobs across other industries. Labor income supported by advertising represents 17% of all personal and proprietor income in the U.S.

APPENDIX IV – Analysis from the Tax Foundation
Maryland Legislators Want to Tax Online Advertising
January 15, 2020

by Ulrik Boesen

<https://taxfoundation.org/maryland-digital-tax/>, Accessed on 1.16.2020

Whenever anyone surfs the internet, they inevitably encounter online ads. They are everywhere, and they are big business. According to Forbes, the market was worth over \$100 billion in the U.S. in 2018. With so much of our daily communication moving online, it has always been just a question of time before implications for the tax code would emerge.

Over the last few years, several countries, the EU, and the OECD have looked at ways to tax the profit streams from this market. Unfortunately, many of the proposals pursued by these countries fail every test of sound tax policy. Fortunately, only a few countries have implemented a tax so far.

The nonneutral and discriminatory nature of the tax has led the U.S. federal government to oppose these taxes. However, Maryland legislators do not share this skepticism, and have introduced a bill to impose a tax on revenues derived from digital advertising.

The sponsors of the bill, Bill Ferguson (D) and Thomas V. “Mike” Miller Jr. (D), expect the tax to raise more than \$100 million per year, which will be appropriated to Maryland’s education program. In 2019, the state’s Kirwan Commission published a set of recommendations that would increase education spending by \$4 billion per year. State lawmakers are looking for new revenue, as both Governor Larry Hogan (R) and leading Democrats have promised not to hike income, property, or sales taxes in 2020.

A tax on digital advertising must rely on the assumption that value is created in a state regardless of a digital advertising provider’s presence in that state other than large user bases. In other words, the taxable event or tax base is an assumed value creation in the meeting between the Maryland user and the online advertisement without regard for the costs of developing and maintaining the software, which allows these online interactions. The tax would apply to revenues derived from digital advertising in the state based on a user’s IP address or reasonable suspicion of location. It will be up to the companies to report their revenue. However, determining location and revenue generation of a user could be very tricky. Think about the problems arising from the use of VPNs (where a user connects to the internet via an out-of-state server), online bots, or the use of ad-blockers.

The rate ranges from 2.5 to 10 percent of gross revenues based on the company’s global annual gross revenues. Companies with revenues below \$100 million are exempt from the tax. Given these high revenue thresholds, the tax seems designed to tax the tech giants. This might be good politics, but it is not sound tax policy. While there can be good reasons to exempt smaller businesses from undue burdens related to the tax, exempting all businesses with revenues below \$100 million narrows the base and drives up the rate.

Not only is the tax nonneutral due to arbitrary revenue thresholds, it also discriminates between online and offline businesses and singles out global advertising services for a higher tax rate than other businesses in the state. The current corporate income tax rate in Maryland is 8.25 percent, which is significantly lower than the gross revenue tax of 10 percent. Corporate income taxes are levied on the income of a company, whereas a tax on gross revenues is levied on revenues before deducting costs. This results in a rate that could exceed 100 percent of profits.

Below is a sample calculation of the difference.

Source: Tax Foundation calculations.

	Traditional Marketing Company	Online Marketing Company
Revenue	\$100	\$100
Costs	\$90	\$90
Profit before taxes	\$10	\$10
Tax Rate	8.25%	10%
Tax Bill	\$0.825	\$10
Profit after taxes	\$9.175	\$0

Tax policy designed to target a single sector or activity is likely to be unfair and have complex consequences as there is a difference between legal tax incidence and effective tax incidence. While the large tech companies are legally obliged to pay the tax, the effective incidence might very well result in local companies in Maryland experiencing increasing marketing cost. The digital economy is not something that can easily be separated out from the rest of the global economy.

Furthermore, traditional advertising is not taxed in Maryland, which means the tax could effectively encourage companies to move marketing dollars away from online platforms. This particular discriminatory element of the tax is likely in violation of the federal Internet Tax Freedom Act, which protects online businesses from punitive or discriminatory taxation.

Maryland lawmakers have called for a modernization of the tax code, and while the proposal for a digital advertising tax fails the tests of sound tax policy, there is reason for updating the tax code to reflect modern consumption patterns. For instance, streaming services like Netflix, Apple Music, and Hulu should be included in the sales tax base. As a rule of thumb, taxation of digital transactions using existing consumption taxes are superior to special taxes on digital services.