



Testimony Before the Maryland Ways and Means Committee
HB 695: Digital Advertising Tax
February 28, 2020

Ms. Chair, Mr. Vice Chair, and members of the committee, thank you for the ability to submit written and oral testimony regarding Maryland House Bill 0695. National Taxpayers Union was founded in 1969 to represent taxpayers at policy debates in Washington, DC and state capitals across the country.

House Bill 0695 would create a new gross receipts tax on digital advertising. While proponents claim that it will raise significant revenue to help finance the Kirwan Commission's recommendations, collecting any revenue is unlikely due to the bill's multitude of legal issues. The bill violates the federal Permanent Internet Tax Freedom Act and is constitutionally suspect, with likely violations of the Commerce Clause and First Amendment. Even if the bill was legally sound, its structure is flawed. If adopted, the tax would create significant economic and legal ramifications for the state.

The Bill's Structure

The bill would create a digital advertising gross receipts tax, imposed on a company's annual gross revenue in the state. Similarly structured as France's [new digital services tax](#), the bill's broad definition of digital advertising includes banner ads, search engine ads, and others posted on a website, an application, or within a piece of software.

The tax rate would increase with a company's global revenues. A company with revenue between \$100 million and \$1 billion would pay 2.5 percent of taxable receipts, rising as high as 10 percent for companies with \$15 billion or more in sales.

Table 1. Tax Rates Under Maryland HB0695

Total Global Revenues	Tax Rate
\$100 million to \$1 billion	2.5%
\$1 billion to \$5 billion	5%
\$5 billion to \$15 billion	7.5%
\$15 billion or more	10%

This structure raises several economic concerns. By taxing digital advertising but not other types of advertising, the bill creates a tax code that is not neutral between similar businesses. Only one narrow industry is taxed, while other competitors are left untaxed. Advertisers would be encouraged to shift their advertising placements from one medium to another not based on sound business reasons, but as a result of tax policy.

The tax violates a second core principle of tax policy: business inputs should be exempt from sales taxes. Taxing a business input leads to what is called tax pyramiding, where the same transaction is taxed multiple times. Companies that host digital advertising would be encouraged to raise their prices to offset the impact of the tax on their profit margin. By taxing gross receipts instead of profits (which allows a company to deduct its costs), effective tax rates skyrocket. A \$15 billion company would need to exceed a 10 percent profit margin to surpass the break-even point on such a tax. Firms would look to offset their revenue hit with higher prices for consumers.

Imagine a small Maryland-based retailer decides to place online ads to encourage shoppers to choose their store over a large retailer. That digital ad would be subject to a tax, raising the cost of the ad. The small retailer would be forced with a difficult choice. Should the retailer then pass that cost along to their consumers, meaning they raise the price of their goods? If they don't think they can raise prices because they'll lose the customer to the large retailer, they might instead have to consider passing the tax to their employees in the form of fewer job opportunities, or by limiting hours, benefits, or wages.

The tax in many ways would function similar to a tariff on digital advertising, limiting the sale within the state. While this seems positive at first blush, it is the businesses placing the ads, not the companies hosting the ads, that are hurt as the price of digital advertising space rises. The bill's impact would be felt by many. Local restaurants, gyms, bakeries, or any Maryland business that uses advertising to complete could be affected.

The Bill's Legal Future Is Uncertain

If adopted, any revenue forecasted for the tax would be unlikely to be collected due to the numerous legal hurdles ahead. As written, the legislation is a clear violation of the federal Permanent Internet Tax Freedom Act (PITFA). Signed into law in 2016 by President Barack Obama, the law prohibits states and localities from assessing taxes on internet access. Second, it prohibits "discriminatory taxes on electronic commerce." Maryland's proposal appears to be an obvious violation of this component of PITFA.

Similar to most states, Maryland does not currently include advertising in its sales tax base, and for very good reasons. State sales tax bases should only include final personal consumption. Taxing business inputs, such as advertising, leads to higher prices for consumers. While both digital and traditional physical advertising activities would be subject to the state's 8.25 percent

corporate income tax, only digital advertising would be additionally subjected to a gross receipts tax as high as 10 percent.

Even if the tax survived a PITFA challenge, it suffers from additional constitutional flaws as well. Because the tax is assessed on annual global revenues, larger global advertising providers would face a higher tax burden than Maryland-only providers, raising questions about whether the law could survive a challenge alleging that it violates the U.S. Constitution's Commerce Clause, which functionally prohibits state laws that discriminate against interstate commerce.

The bill also likely violates the First Amendment. In *Grosjean v. American Press Co.* and *Minneapolis Star Tribune Co. v. Commissioner*, the U.S. Supreme Court considered the impact of taxes on the news media, ruling that industry-specific taxes violate the First Amendment's speech protections. In a similar case, the Maryland Court of Appeals ruled that advertising taxes were unconstitutional violations of the First Amendment. Taxing digital advertising, a key revenue stream for media companies, would raise similar challenges.

Conclusion

Legislators in Maryland are searching for new revenue to pay for the [Kirwan Commission's](#) educational recommendations, but the digital advertising tax does not pass the smell test. Even though it was proposed by a Nobel Prize winning economist and [strikes some as a good idea](#), the tax violates federal law and is also likely unconstitutional. Instead of collecting \$100 million from the tax, the state is more likely to find itself spending a pretty penny on legal fees to defend an indefensible proposal.

February 27, 2020

Dear Maryland Legislator,

On behalf of the undersigned organizations and businesses, representing a diverse coalition of nonprofit organizations and Maryland small businesses, we write to express our serious concerns regarding Senate Bill 2 and House Bill 0695, the "Digital Advertising Gross Revenues-Taxation" bills. If adopted, this tax would significantly impact digital advertising within the state of Maryland, hurting our ability to sustain and grow our businesses.

Senate Bill 2 and House Bill 0695 would create a new tax on digital advertising revenues of companies with more than \$100 million in global revenue. The tax could reach as high as 10 percent of revenues. The bills violate the Permanent Internet Tax Freedom Act and are constitutionally suspect.

Even if the legal maladies could be solved, this onerous tax should not be adopted. These bills are crafted to tax large companies that host digital advertising, but their impact will not be felt simply by those firms. Instead, Maryland-based small businesses and nonprofit organizations, such as ours, will feel the pinch.

Any tax on digital advertising will be passed on to companies and organizations seeking out Maryland audiences online, like ours. That means higher prices for digital advertising to consumers in our state, leaving us to feel the real pain of the tax..

Digital advertising is essential. It empowers groups and businesses like ours to compete in a difficult marketplace. By advertising our stores, our products, our restaurants, and our missions, we can compete with large, global entities to create jobs for Marylanders and advance our missions improving the Old Line State.

We understand the importance of funding education in the state of Maryland, but imposing unconstitutional taxes on digital advertising should not be a solution. For the sake of our organizations and small businesses, we hope that you reject this poorly constructed proposal.

Sincerely,

National Taxpayers Union
Maryland Chamber of Commerce
127 Creative
360 Your Business
American Advertising Federation of
Baltimore
Americans for Tax Reform

Antietam Broadband
Baltimore Business Journal
Bubble Social Media Marketing
Care Net Pregnancy Center of Frederick
Catherine Foundation Pregnancy Resource
Center
Commercial Insurance Managers, Inc

Devaney & Associates
Herrmann Advertising
High Rock Studios
Hulu
Landmark Digital
Laura's Eyes Photos
Manning Media Inc
Millennium Marketing Solutions
New North
Orange Element

Pink Dog Digital
RCI Custom
REJ & Associates, Inc
Saunders Tax and Accounting
SMiles Media
SysTech Networks, LLC
The Alternative Board
Total Tax Service
TSL Karaoke Entertainment