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Section of Taxation

To: Members of the House Ways and Means Committee

From: Maryland State Bar Association Section of Taxation

Date: February 24, 2021

Subject: **House Bill 1200** – "**Digital Advertising Gross Revenues Tax - Exemption and Restriction"**
Senate Bill 787– "**Digital Advertising Gross Revenues Tax - Exemption and Restriction"**

Position: **Oppose**

The Maryland State Bar Association ("MSBA") Section of Taxation reviewed the proposed amendments to Maryland's Digital Advertisement Gross Revenues Tax (the "Digital Advertising Tax,") and its position that this tax likely violates federal law remains unchanged.

Established on August 8, 1896, MSBA is a voluntary bar association for the state of Maryland. MSBA provides member services and to promote professionalism, diversity in the legal profession, access to justice, service to the public and respect for the rule of law. MSBA's Section of Taxation is composed of approximately 2,000 Maryland licensed attorneys. The general purpose of the Section of Taxation's legislative review is to analyze proposed legislation to determine whether they are constitutionally and legally sufficient, identify, and address legal risks, and ensure that tax laws are clear and concise.

Digital Advertisement Gross Revenues Tax

The Digital Advertising Tax imposes a new tax on certain businesses providing "digital advertising services" in Maryland.[1] "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."[2] A "digital interface" is defined to encompass "any type software, including a website, part of a website, or application, that a user is able to access."[3] Because the law was enacted by way of an override of a gubernatorial veto, it takes effect on March 14, 2021.[4] Starting April 15, 2015, providers of digital advertising services

[1] Md. Code Ann. Tax-Gen. § 7.5-101, *et. seq*.
[2] Md. Code, Tax-Gen. § 7.5-101(d).
[3] Md. Code, Tax-Gen. § 7.5-101(e).
[4] *See* Article II, § 17(d) of the Maryland Constitution.

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that expect to meet certain revenue thresholds must file a declaration of estimated tax and pay at least 25% of the "reasonably estimated" tax.[5]

The Section of Taxation's position – that the Digital Advertising Tax likely violates the Internet Tax Freedom Act because it imposes a tax on digital advertising services, while not imposing the tax on similar non-digital advertising services – remains the same.[6]

Proposed Modifications to Digital Advertisement Tax

House Bill 1200 ("HB 1200"), which was cross-filed with Senate Bill 787, seeks to exempt certain advertising service providers by modifying the definition of "digital advertising services" to exclude advertisement services on digital interfaces that are owned or operated by or operated on behalf of entities that primarily engage in either "the business operating of a broadcast television or radio station" or "the business of newsgathering, reporting, or publishing articles or commentary about news, current events, culture, or other materials of public interest."[7] Additionally, HB 1200 seeks to prohibit digital advertisement service providers from "directly" passing on the Digital Advertising Tax to their customers "by means of a separate fee, surcharge, or line-item."[8] As introduced, HB 1200 would take effect July 1, 2021 and apply to all taxable years beginning after December 31, 2020.[9]

While the Section of Taxation values the General Assembly's attempt to alleviate some of the underlying legal infirmities that plague the Digital Advertising Tax, the proposed modifications likely fall short of making this law constitutionally and legally sufficient. In fact, the proposed modifications may exacerbate the discriminatory application and effect of this tax.

The proposed exemptions increase the likelihood that a court will determine that the arbitrary classifications 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. Additionally, the proposed amendments that prohibit service providers from separately stating the Digital Advertising Tax on the bill to their customers may violate the free speech protections set forth in

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[5] Md. Code, Tax-Gen. §§ 7.5-201(b)(1); 7.5-301(b)(1).

[6] Attached is the MSBA Section of Taxation's letter to Senate Budget and Taxation Committee, Maryland General Assembly (Jan. 29, 2020), (opposing to Senate Bill 2, which was effectively rolled into HB 732 in the final 2 days of the shortened 2020 legislative session.)

[7] *See* HB 1200, modifying Md. Code Ann. Tax-Gen. § 7.5-101.

[8] *See* HB 1200, modifying Md. Code Ann. Tax-Gen. § 7.5-102.

[9] HB 1200 is not drafted as an emergency law. Article XVI, § 2 of the Maryland Constitution, provides that certain laws may effect immediately on signature by the Governor if they contain a provisions declaring then "an emergency law ... necessary for the immediate preservation of the public health or safety ..." and they have received a three-fifths vote for passage in each house of the General Assembly.

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the First and Fourteenth Amendments.[10] Specifically, a court may find that proposed provision restricts speech by prohibiting service providers from placing a written line item on customer bills to notify them of the origin and amount of the charge to recover the gross revenues tax and from otherwise communicating with their customers about the tax on their billing statements.[11]

For the reason(s) stated above, the Section of Taxation **opposes HB 1200 and urges the Committee to recommend an amendment that will repeal the Digital Advertising Tax**.

If you have questions, please feel free to address them to Peter Haukebo at peter.haukebo@frosttaxlaw.com or MSBA's Legislative Office at (410)-269-6464 / (410)-685-7878 ext: 3066 or at Richard@MSBA.org.

[10] *See e.g.*, *BellSouth Telecomm., Inc. v. Farris*, 542 F.3d 499 (6th Cir. 2008)(invalidating a clause that prohibited providers from recovering their costs for a gross receipts tax by stating the tax on customer bills on First Amendment grounds.)

[11] *Id.* at 500.

Attachment

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To: Members of the Senate Budget and Taxation Committee

From: DeAndre Morrow, Legislative Committee, Tax Council

Date: January 29, 2020

Subject: **Senate Bill 2 – "Digital Advertising Gross Revenues – Taxation"**

Position: **Oppose**

The Maryland State Bar Association ("MSBA") opposes **Senate Bill #2 – Digital Advertising Gross Revenues – Taxation** (the "Bill").

By way of background, the Bill imposes a new tax on businesses providing "digital advertising services" in Maryland. The Bill 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." A business provides digital advertising services if either of the following conditions are met: the digital advertising services appear on the device of a user:

(1) with an Internet Protocol Address that indicates that the user's device is located in Maryland; or

(2) who is known or reasonably suspected to be using the device in Maryland.

If either of these conditions are met, the Bill imposes the tax on a business's "annual gross revenues," defined as "income or revenue from all sources, before any expenses or taxes, computed according to generally accepted accounting principles," delivered from digital advertising services in Maryland.

The Bill, as drafted, likely violates the Internet Tax Freedom Act (the "ITFA"). In 1998, Congress enacted the ITFA to prohibit state and local governments from imposing "multiple or discriminatory taxes on electronic commerce."[1] The ITFA specifically defines what constitutes a "discriminatory tax." "Discriminatory tax" is defined to include "any tax imposed by a State . . . on electronic commerce that . . . is not generally imposed and legally collectible by such State . . . on transactions involving similar property, goods, services, or information accomplished

[1] Pub. L. No. 105-277, Title XI, 112 Stat. 2681 (1998) (enacted as a statutory note to 47 U.S.C. § 151); ITFA § 1101(a). Certain provisions of ITFA were subsequently amended by legislation enacted in 2004 and 2007. See Pub. L. No. 108-435, 118 Stat. 2615 (2004); Pub. L. No. 110-108, 121 Stat. 1024 (2007). All references to the ITFA in this testimony refer to the ITFA in its current form, unless specifically stated otherwise.

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through other means. . . ."[2] "Electronic commerce" is defined as "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information. . . ."[3] If a transaction is generally not taxed when it is conducted through traditional commerce, the ITFA bars a state from taxing a similar transaction when conducted through e-commerce.

If enacted as currently drafted, the Bill would impose a tax on digital advertising services, while not imposing the tax on similar non-digital advertising services. For example, tax could be imposed on the annual gross revenues derived from the advertising of an item on a website, but tax would not be imposed on annual gross revenues derived from the advertising of that same item in magazines or on billboards. This discriminatory treatment is precisely what the plain language of the ITFA prohibits. The scenario created by the Bill is eerily similar to the facts in an Illinois State Supreme Court case regarding the legality of a nexus provision that applied to remote sellers who advertised via website but not remote sellers who advertised through traditional commerce (e.g., mail order catalogs, telephone sales, etc.). In *Performance Marketing Association v. Hamer*, Illinois amended a law to require out-of-state internet retailers to collect tax if they had a contract with a person in Illinois who displayed a link on a website that connected an Internet user to that remote seller's website.[4] The taxpayer argued that if it used any advertising method other than the Internet, it would not have an obligation to collect and remit tax on its sales.[5] But for the taxpayer's use of the Internet, there was no collection obligation on its sale. The Illinois Supreme Court found that this law violated the ITFA because a tax collection obligation existed only on the party engaged in electronic commerce.[6] The remedy in this case was to declare the amendment "void and unenforceable."[7] If enacted as currently drafted, the Bill may share the same fate.

For the reason(s) stated above, the MSBA **opposes the Bill and urges an unfavorable Committee report**.

If you have questions, please contact DeAndre Morrow at Dmorrow@ReedSmith.com or MSBA's Legislative Office at (410)-269-6464 / (410)-685-7878 ext: 3066 or at Richard@MSBA.org and Parker@MSBA.org**.**

[2] ITFA § 1105(2)(A)(I).
[3] ITFA § 1105(3).
[4] 998 N.E.2d 54 (Ill. 2013).
[5] *Id.* at 58.
[6] *Id.* at 59.
[7] *Id* at 60.