Maryland General Assembly Votes to Adopt Digital Advertising Gross Revenue Tax & Expand Sales Tax to Digital Products

March 20, 2020

Acting swiftly before recess on March 18, 2020, the Maryland General Assembly has passed two important bills aimed at the taxation of digital advertisements and products. H.B. 732 permits Maryland to impose a Digital Advertising Gross Revenues Tax and H.B. 932, known as the 21st Century Economy Fairness Act, broadens the sales tax base to the taxation of digital products. Both measures will now be sent to Governor Hogan for review, where a veto is anticipated.

If H.B. 732 becomes law, Maryland will be the first state in the country to impose a separate and unique tax upon digital advertising services—though New York recently introduced a substantially similar bill that mirrors Maryland's provisions. Effective July 1, 2020 for tax years beginning after December 31, 2020, H.B. 732 taxes those digital advertising services 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 language is broad in nature and would encompass significantly large platforms, as the bill requires a taxpayer have over $100 million in annual gross revenue and at least $1 million in annual gross revenue from digital advertising services sourced to Maryland in order to be subject to the tax. The method by which digital advertising services is to be sourced will remain an open question in the short term. The bill specifically directs the Comptroller to promulgate regulations to determine revenue sourcing.

The applicable tax rate can range from 2.5% to 10%, and will be determined by a taxpayer's annual gross revenue as follows:

2.5% for persons with annual gross revenue of $100 million or more
5% for persons with annual gross revenue of $1 billion or more
7.5% for persons with annual gross revenue of $5 billion or more
10% for persons with annual gross revenue of $15 billion or more

There are significant legal challenges that need to be considered in conjunction with Maryland's unique approach to the taxation of digital advertising services. Most notably, the bill is inconsistent with the protections afforded by the federal Internet Tax Freedom Act (ITFA) as it is directed only at digital advertising services and excludes taxation of non-digital advertising services. Further, the thresholds for being subject to the tax, i.e. $100M in gross annual revenue and $1M in Maryland gross revenue from digital advertising, raise Commerce Clause concerns to the extent these thresholds result in Maryland domestic companies being treated differently from foreign taxpayers.

Next Steps

The revenue related to these proposed tax measures will provide funding to support early childhood education, primary and secondary education. However, given anticipated legal challenges the Digital Advertising

Gross Revenue Tax and the Governor's stated opposition to tax increases, a veto is likely. Upon veto, the bill will return to the General Assembly in May for an override vote, which requires a three-fifths approval. We will continue to monitor legislative activity, as current economic conditions are also expected to impact future votes.

Please contact Caplin & Drysdale if you would like to discuss these potential changes.

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