# Maryland Enacts Controversial Tax on Digital Advertising

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On February 12, 2021, the General Assembly of the State of Maryland enacted legislation imposing the Digital Advertising Gross Revenues Tax (the "Act"), overriding a prior veto of the legislation by Maryland Governor Larry Hogan.  The Act imposes a tax, at rates of up to 10%, on gross revenues "derived from digital advertising services in the state."  The tax could be extremely burdensome, and within days of the Act's enactment, a number of advertising industry groups commenced litigation, in an effort to block implementation of the Act.  The fate of the Act is likely being closely watched by the legislatures of other states, which may wish to enact similar legislation.  The fate of the Act should also be closely watched by advertisers and providers of advertising services, in light of the Act's troubling features and the risk that it may be copied by other states.

Under the Act, potentially taxable digital advertising services 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."  The portion of revenues that are treated as being from Maryland is computed using a fraction, the numerator of which is annual gross revenues derived from digital advertising services in Maryland, and the denominator of which is annual gross revenues derived from digital advertising services in the United States.  Gross revenues from Maryland are to be identified under regulations that have not yet been issued.

Although the tax is imposed on gross revenues derived from digital advertising services in Maryland, the rate of the tax increases with the taxpayer's annual gross revenues from all sources, not just revenues from digital advertising services, and not just revenues from Maryland.  The tax rates, as a function of global annual gross revenues, are as follows:

| Global Annual Gross Revenues | Tax Rate |
|---|---|
| $100,000,000 to $1,000,000,000 | 2.5% |
| $1,000,000,001 to $5,000,000,000 | 5.0% |
| $5,000,000,001 to $15,000,000,000 | 7.5% |
| More than $15,000,000,000 | 10.0% |

Persons with annual gross revenues derived from digital advertising services in Maryland of $1,000,000 or more are required to file a tax return with Maryland.  Persons that reasonably expect to have annual gross revenues derived from digital advertising services in Maryland of more than $1,000,000 are required to file quarterly estimated tax returns.  The Act's return filing obligation appears to apply even where the taxpayer has less than $100,000,000 of global annual gross revenues.

The Act is expected to become effective on or about March 14, 2021, but the tax will apply retroactively from January 1, 2021.  Initial estimated tax declarations under the Act will be due on April 15, 2021.

The Act's legislative history suggests that the tax was directed at very large providers of digital advertising services, such as Google and Facebook, but the Act could also impact other persons, including advertisers.  The Act does not prohibit providers of digital advertising services from passing through the tax to purchasers of advertising services.  There is proposed legislation in Maryland that would prohibit providers of digital advertising services from explicitly passing the tax through to purchasers of advertising services, but there is no guarantee that the proposed legislation will be enacted, and even if it were enacted, it would be difficult to prevent providers of digital advertising services from reimbursing themselves for the tax by increasing their prices.

Moreover, the language of the Act is extremely vague, so its incidence is unclear.  For example, it is not clear what types of revenue are considered to be "derived from digital advertising services," and it is, therefore, not hard to see how the tax could potentially be applied to persons other than advertising service providers.  At this point in time, it is not possible to rule out the possibility that advertisers, and persons between advertisers and advertising service providers, could be swept up into the net cast by the Act.

The Act has several other very troubling features.  Among the Act's most burdensome features is the fact that the tax is imposed on gross revenues, rather than net income.  The effective rate of the tax could, therefore, be more than 100% of a taxpayer's net income from Maryland sources.  Even taxpayers with net losses could be liable for the tax.  Moreover, the tax is imposed on top of Maryland's 8.25% corporate income tax.

In light of the U.S. Supreme Court's *Wayfair* decision, there is little doubt that Maryland will attempt to impose the tax on taxpayers with no physical presence in Maryland.  Indeed, it is believed by some that the tax was specifically directed at taxpayers outside of Maryland.

The validity of the tax has been questioned, as it is not clear that the Act complies with the requirements of the federal Internet Tax Freedom Act, the Commerce Clause of the U.S. Constitution, or the Due Process Clause of the U.S. Constitution.  A lawsuit challenging the validity of the Act has already been filed.  On February 18, 2021, less than a week after the Act's enactment, the Chamber of Commerce of the United States of America, the Internet Association, NetChoice, and the Computer & Communications Industry Association filed a lawsuit in the U.S. District Court for the District of Maryland, Northern Division, seeking to enjoin implementation of the tax.

Since the outcome of the recently commenced litigation cannot be predicted, and since tax payments under the Act could become due before the outcome of the litigation is known, providers of digital advertising services that are potentially subject to the tax should determine whether they are obligated to file tax returns under the Act and should take steps to protect their rights to refunds of the tax in the event the tax is declared invalid.  Advertisers should consider how the Act might impact them, including what they should do if a provider of digital advertising services were to attempt to pass the tax through to them.