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February 7, 2020

The Honorable Andrew Serafini
Maryland General Assembly
321 James Senate Office Bldg.
Annapolis, MD 21401

Re: Senate Bill 2 – Digital Advertising Gross Revenues – Taxation

Dear Senator Serafini:

You have asked for advice about the constitutionality of Senate Bill 2. The bill would impose a tax on digital advertising revenues based on advertising directed to users in Maryland. Taxing income from business activity in the State is not novel. At the same time, taxing digital advertising revenues directed to users in a state has not been done before. The law does not always fit neatly with emerging technologies and that makes it difficult to predict how a court would rule on legal challenges to regulation of those technologies. Nevertheless, while Senate Bill 2 raises issues—but not insurmountable—namely Commerce Clause, First Amendment, preemption based on the federal Internet Tax Freedom Act, Due Process, and Equal Protection, I do not think that Senate Bill 2 is clearly unconstitutional.[1]

Description of Senate Bill 2

Senate Bill 2 would enact a new "digital advertising gross revenues tax." The tax would be "imposed on annual gross revenues of a person derived from digital advertising services in the State." Digital advertising services are defined in the bill 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." And such digital

[1] The Office of the Attorney General evaluates legislation under a "not clearly unconstitutional" standard. 71 *Opinions of the Attorney General* 266, 272 n.12 (1986).

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advertising services would be considered to be "provided in the State" for purposes of the tax "if the digital advertising services appear on the device of a user" either "with an internet protocol address that indicates that the user's device is located in the State" or "who is known or reasonably suspected to be using the device in the State."

The rate for the tax is:

(1) 2.5% of the assessable base for a person with global annual gross revenues of $100,000,000 through $1,000,000,000;
(2) 5% of the assessable base for a person with global annual gross revenues of $1,000,000,001 through $5,000,000,000;
(3) 7.5% of the assessable base for a person with global annual gross revenues of $5,000,000,001 through $15,000,000,000;
(4) 10% of the assessable base for a person with global annual gross revenues exceeding $15,000,000,000.

The bill requires "[e]ach person that, in a calendar year, has annual gross revenues derived from digital advertising services in the state of at least $1,000,000" to file a tax return. The revenue from the tax would be put into the Blueprint for Maryland's Future Fund, identified in Education Article § 5-219(g).

A gross receipts tax, unlike a sales tax, is imposed on the seller of the goods and/or services at issue rather than on the buyer. Persons doing business in Maryland are subject to the State's net income corporate tax of 8.25%. Tax-General Article ("TG"), § 10-105(b). The Maryland taxable income of a corporation is the amount of the entity's income that is attributable to Maryland. TG § 10-101(i)(2). In addition to the net income tax, Maryland currently imposes a gross receipts tax on some premiums earned by insurance companies, Insurance Article §§ 4-209, 6-103, and a 2% tax on gross receipts on certain public service companies under the Public Service Company Franchise Tax in TG § 8-403. Currently, Maryland's sales tax is imposed on a retail sale in the State (and a use in the State) of either tangible personal property or a taxable service, TG § 11-102(a). The definition of "taxable service" does not include advertising services. TG § 11-101(m).

Analysis

As stated previously, in my view, the bill raises issues concerning: (1) preemption under the federal Internet Tax Freedom Act, which prohibits state law discrimination against electronic commerce; (2) the Due Process Clause; (3) the Commerce Clause; (4) the Equal Protection Clause; and (5) the First Amendment.

The Internet Tax Freedom Act

The Internet Tax Freedom Act ("ITFA"), which is codified at 47 U.S.C. § 151 (note), among other things prohibits discriminatory taxes on electronic commerce. Relevant for your question is the definition of "discriminatory tax" as any tax imposed by a State or political subdivision thereof on electronic commerce that

i. is not generally imposed and legally collectible by such State or such political subdivision 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 or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;

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;

iv. establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means.

§ 1105(2)(A). "Electronic commerce" is defined to mean "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license; offer or delivery of property, goods, services, or information, whether or not for consideration." § 1105(3).

Whether a reviewing court would find Senate Bill 2 imposes a tax on a "transaction conducted over the Internet or through Internet access" that is "not generally imposed and legally collectible by" Maryland "on transactions involving similar" services that are "accomplished through other means" would depend on what the reviewing court would find to be the "transaction" on which the tax is imposed, and whether that transaction is one that is necessarily conducted over the internet or through internet access. If the reviewing court found that the relevant "transaction" being taxed for purposes of the ITFA is the transmission of digital advertising to a user, then that transaction would presumably be one that occurs over the internet or through internet access, and the tax would likely be preempted by the ITFA, unless advertising over the internet is different enough from advertising by other means that the two types of advertising would not qualify as transactions of sufficiently "similar" services. If the court concludes that digital advertising is not different than other types of advertising, the State could identify a complementary tax on similar "transactions."

It is possible, however, that a reviewing court would find the relevant "transaction" for purposes of the ITFA could be the sale of the advertising services from which the revenue subject to taxation is derived. And that sale need not be conducted over the internet or through internet access for the proposed tax in Senate Bill 2 to apply. Rather, the proposed tax applies to the revenue derived from providing digital advertising services directed at users in Maryland regardless of whether the advertiser purchases those advertising services from the taxpayer over the internet or through some other means. Thus, arguably, the tax could be characterized as "generally imposed and legally collectible" by Maryland without regard to whether the transaction is conducted over the internet. In that case, a court is unlikely to find any discrimination against "electronic commerce" as defined by the ITFA.

Moreover, depending on the business arrangement between an advertiser and an internet platform, the exact amount of the revenue earned from digital advertising might depend on how many users view a particular advertisement or click on the advertisement, and those actions would take place over the internet. But is not clear whether those would be the relevant transactions for purposes of the ITFA. Even if they are, it is also not entirely clear whether the transactions would be for services that are sufficiently similar to those involved in advertising conducted by other means (the compensation for which are presumably not based on the number of "clicks"), such that the tax would be impermissibly discriminating between "transactions" that are conducted over the internet and those of "similar" services accomplished through other means.

Although digital advertising is associated with the internet in a way that other types of advertising would not be, the ITFA does not define "electronic commerce" to mean any type of commerce that is related to the internet. The Act instead defines the term more narrowly to mean only those "transaction[s] conducted over the Internet or through Internet access." § 1105(3); *see also America Online, Inc. v. Commissioner*, 942 A.2d 236, 239-240 (Pa. Commw. Ct. 2008) (concluding that a management service to maintain modems that were physically located at a Sprint facility, though related to the internet, was not "electronic commerce" under the ITFA because the purchase of the service was not conducted "over the internet").

In addition, there is generally an "assumption that the historic police powers of the States [are] not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Altria Grp., Inc. v. Good,* 555 U.S. 70, 77 (2008) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218,230 (1947)). That presumption "applies with particular force when," as here, "Congress has legislated in a field traditionally occupied by the States." *Id.* Thus, when the text of a preemption clause is susceptible of more than one plausible reading, courts ordinarily "accept the reading that disfavors pre-emption." *Id.* (quoting *Bates v. Dow Agrosciences LLC,* 544 U.S. 431, 449 (2005)). Given that presumption against preemption and the lack of any direct authority interpreting the ITFA in the context of a tax on digital advertising services, I cannot say that Senate Bill 2 would be clearly preempted by federal law. There is, however, certainly an argument that the proposed tax in Senate Bill 2 would discriminate against electronic commerce within the meaning of the ITCA and thus some real risk that it would be held preempted. By contrast, a tax that applies to revenue from both digital and non-digital advertising would not raise concerns.

The Due Process Clause

I also considered whether the proposed tax is consistent with the Due Process Clause of the United States Constitution. Under the Due Process Clause, the "controlling question" in the tax context is "whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 444 (1940). To satisfy that standard, there must be a sufficient nexus between the taxing state and the taxpayer, i.e., "some definitive link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." *Allied-Signal, Inc. v. Director, Div. of Taxation,* 504 U.S. 768, 777 (1992) (internal quotation omitted).

Under Senate Bill 2, there appears to be a sufficient nexus between Maryland and the taxpayer, as well as the activity being taxed, to satisfy the Due Process Clause. An out-of-state taxpayer is not subject to the proposed tax in Senate Bill 2 unless the taxpayer earns revenues over $1,000,000 during the taxable year from advertising directed to users in Maryland. And if an entity is earning that much revenue from advertising services that are targeted to Maryland, there can be little doubt that the entity has availed itself of the privilege of carrying on business in the State. *See South Dakota v. Wayfair, Inc.,* 138 S. Ct. 2080, 2099 (2018) (concluding that a South Dakota statute setting thresholds of $100,000 worth of sales or 200 transactions in the state before an entity was required to collect the state's sales-and-use taxes satisfied the Court's nexus requirement because that "quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota"). In other words, Maryland is affording the taxpayer the opportunity to earn money by engaging in business in Maryland, using its connections to people located in Maryland as well as Maryland's telecommunications and digital infrastructure. Maryland is thus giving something of value "for which it can ask return." *J.C. Penney Co.,* 311 U.S. at 444. In my view, therefore, the proposed tax would likely satisfy the Due Process Clause.

The Dormant Commerce Clause

Another issue that will likely arise if Senate Bill 2 is enacted is whether the bill violates the Commerce Clause of the U.S. Constitution, which grants Congress the authority to regulate interstate commerce. The Commerce Clause "has long been understood, as well, to provide 'protection from state legislation inimical to the national commerce [even] where Congress has not acted.'" *Barclays Bank PLC v. Franchise Tax Bd. of Cal.,* 512 U.S. 298, 310 (1994) (quoting *Southern Pac. Co. v. Arizona ex rel. Sullivan,* 325 U.S. 761 (1945)). That "'negative command, known as the dormant Commerce Clause,' prohibits States from legislating in ways that impede the flow of interstate commerce." *Star Sci. Inc. v. Beales,* 278 F.3d 339,355 (4th Cir. 2002) (quoting *Oklahoma Tax Comm 'n v. Jefferson Lines, Inc.,* 514 U.S. 175, 179 (1995)).

A tax is valid for purposes of the Commerce Clause so long as it (1) applies to an "activity with a substantial nexus with the taxing State," (2) is "fairly apportioned," (3) "does not discriminate against interstate commerce," and (4) is "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady,* 430 U.S 274, 279 (1977).

As to the first prong, after the Supreme Court's recent decision in *Wayfair,* it is now clear that this nexus requirement is essentially the same as the nexus requirement under the Due Process Clause. Until *Wayfair,* the Supreme Court had held that an out-of-state vendor had to have a physical presence in the taxing state before the vendor could be required to collect sales-and-use taxes on purchases shipped into the taxing state. *See Quill Corp. v. North Dakota,* 504 U.S. 298 (1992). Based on that doctrine, some taxpayers had argued that the same type of physical presence was required before states could impose gross receipts or net income taxes on out-of-state taxpayers, even when those taxpayers did significant business in the taxing state. In the *Wayfair* case, the Supreme Court overturned *Quill* and held that a physical presence is not an absolute constitutional requirement to satisfy the nexus prong under the dormant Commerce Clause. *See Wayfair,* 138 S. Ct. at 2099. Instead, a tax must merely meet the four-prong *Complete Auto* test to be constitutional under the dormant Commerce Clause. *Id.* The Court found that South Dakota's sales-and-use-tax statute unquestionably satisfied that prong, because the statute applied "only to sellers that deliver more than $100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis," and such a "quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota." *Id.* Likewise, it is my view that the proposed tax in Senate Bill 2 is likely to satisfy the Commerce Clause's nexus requirement.

As to the second prong, a tax is fairly apportioned if it is levied only on interstate activity that reasonably represents the activity within the taxing state. *See, e.g., Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 169 (1983). The purpose of this requirement is "to ensure that each state taxes only its fair share of an interstate transaction." *Comptroller v. Wynne,* 431 Md. 147, 165 (2013). To determine whether a tax satisfies this standard, a court typically will first examine whether the tax is "internally consistent," i.e., whether, if every state adopted the same tax, that hypothetical state of affairs would "place interstate commerce at a disadvantage" as compared with intrastate commerce. *Jefferson Lines, Inc.,* 514 U.S. at 185. "A failure of internal consistency shows ... that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax." *Id.* If the tax is internally consistent, the court will then examine whether the tax is "externally consistent," i.e., "whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Id.* That second inquiry focuses on "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg v. Sweet,* 488 U.S. 252,262 (1989).

With respect to internal consistency, Senate Bill 2 appears to authorize the State to tax those digital advertising services that are directed at users in the State. At that general level, if the tax is indeed reaching only those advertising services that are directed to users in Maryland, then the tax will be internally consistent because, if every state imposed an identical tax on digital advertising, no more than all the revenue from the digital advertising service would be taxed. Each state would only be taxing the revenue from digital advertising services that are directed at users in its state, and there would be no double taxation of the same advertising services.

It may be possible, however, that two states could both impose the same tax and both tax the same digital ad service. This might happen, for example, if the user's device has an IP address that indicates that it is located in one state but the user is using that device in another, or thought to be doing so. The Comptroller's Office, in implementing the bill, could take steps to alleviate any potential concerns along these lines through regulations that would avoid the possibility of double taxation. Another approach would be to amend the bill either to provide for a credit for taxes paid to another state when it is necessary to do so or to change the apportionment criteria such that they could not lead to the same service being taxed in more than one state.

As for external consistency, the tax in my view is externally consistent on its face because it is designed to ensure that the State reaches only the revenue that is fairly attributable to economic activity in Maryland, i.e., the revenue from digital advertising services that are directed to users of devices in Maryland. *See, e.g., Complete Auto*, 430 U.S. at 287 (approving apportionment based on gross receipts); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938) (same). More specifically, the proposal would tax only the revenue derived from the advertisements that "appear on the device of a user" either "with an internet protocol address that indicates that the user's device is located in the State" or "who is known or reasonably suspected to be using the device in the State." Those criteria seem designed to "reasonably reflect[] the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262.

If the criteria used in Senate Bill 2 were shown not to accurately reflect the extent of the taxpayer's economic activity in Maryland, however, there would be a problem. For example, if a person challenging the tax was able to prove that IP addresses are an unreliable way to judge whether a device is located in a particular state, that could raise questions about whether Maryland is taxing out-of-state activities. The Supreme Court, however, has consistently held that "States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportion to the business transacted... in that State or has led to a grossly distorted result." *Moorman Mfg. Co., v. G.D. Bair*, 437 U.S. 267, 274 (1978) (internal quotation marks omitted); *see also Butler Bros. v. McColgan*, 315 U.S.501, 507 (1942) ("One who attacks a formula of apportionment carries a distinct burden of showing 'clear and cogent' evidence that it results in extraterritorial values being taxed."). The Supreme Court "has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities ... and has declared that rough approximation, rather than precision is sufficient." *International Harvester Co. v. Evatt*, 329 U.S. 416, 422 (1947) (internal quotation omitted). Courts will therefore decline to "nullify honest state efforts to make apportionments" absent "a palpably disproportionate result." *Id.* at 422-23. Thus, a taxpayer would have the burden to establish that the method chosen by the General Assembly creates "palpably disproportionate result[s]..." *Id.* Accordingly, Senate Bill 2 is not clearly unconstitutional on that ground.

As to the third prong, the proposed tax does not appear to discriminate against interstate commerce. The tax, on its face, does not tax only those activities that occur in interstate commerce or tax interstate activities differently from intrastate ones. In fact, the location of the person providing the digital advertising service and the location from which the service originates are irrelevant under the proposed tax. It is instead the location of the device in the State, and thus the location of the person viewing the advertising on the device, that matters. As such, the proposed tax would apply both to a Maryland-based provider of digital advertising services and a non-Maryland-based provider, so long as both earn more than $1,000,000 in revenue from those advertising services in Maryland during the taxable year and at least $100,000,000 in annual gross revenues during that same year. The tax, therefore, is neutral on its face.

At the same time, even though such a scheme would not discriminate against interstate commerce on its face, the Commerce Clause also applies to tax regimes that have the "purpose" or "effect" of discriminating against interstate commerce. *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 270 (1984) (citations omitted). "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 201 (1994). *See also Hughes v. Oklahoma,* 441 U.S. 322, 336 (1979) (explaining that a law can "discriminate[] against interstate commerce either on its face or in practical effect"). If the thresholds do, in fact, operate in practice to favor in-state over out-of-state interests, the relevant standard for judicial review may depend on whether that constitutes actual *discrimination* against interstate commerce or merely an incidental burden on interstate commerce. If the latter, then the tax will be upheld "unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." *Department of Revenue of Kentucky v. Davis,* 553 U.S. 328, 338-39 (2008) (quoting *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970)). But, if the former, the law must serve a "legitimate local purpose" that "could not be served as well by available nondiscriminatory means." *Maine v. Taylor,* 477 U.S. 131, 138 (1986). Nevertheless, "[t]he Supreme Court has not directly spoken to the question of what showing is required to prove discriminatory effect where, as here, a statute is evenhanded on its face," *Direct Marketing Ass'n v. Brohl,* 814 F.3d 1129, 1142 (10th Cir. 2016) (internal quotation omitted). As a result, it is not entirely clear which of these two standards would govern in the event of a challenge here. At the very least, Senate Bill 2 does not clearly discriminate against interstate commerce.

Finally, as to the fourth prong, the tax appears to be fairly related to the services provided by the State. Given that the tax applies only to revenue from digital advertising services directed at in-state users and the entities providing digital advertising services are availing themselves of the State's markets, including the State's telecommunications and digital infrastructure, the tax is fairly related to services provided by the State. "[T]he relevant inquiry" under this prong "is not" to weigh "the *amount* of the tax" with "the *value* of the benefits allegedly bestowed" by the State so as to determine whether the amount of the tax exceeds the value provided to the taxpayer by the State. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 625 (1981) (emphasis in original). Rather, the question is merely whether "the *measure* of the tax" is "reasonably related to the extent of the contact" with the taxing state. *Id.* at 626 (emphasis in original). Because under Senate Bill 2 the proposed tax is to be measured based on the revenue earned from digital advertising directed to Maryland users, this requirement would likely be determined to be satisfied.

Equal Protection

The next issue is whether Senate Bill 2 presents any questions under the Equal Protection Clause, or Maryland's analogous protections in the Declaration of Rights. To the extent that the proposed tax treats digital advertising services differently from other types of advertising services, a taxpayer might raise an argument under the Equal Protection Clause. Because businesses engaged in non-digital advertising services are not a protected class, however, the tax would be upheld so long as there is a rational basis to support that distinction. *See Harrah Jndep. Sch. Dist. v. Martin*, 440 U.S. 194, 199 (1979) (explaining that tax statutes, unless they are drawn based on a "suspect classification," will survive an equal protection challenge if the classification drawn by the statute is "rationally related to the State's objective"). "Legislatures have especially broad latitude in creating classifications and distinctions in tax statutes." *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540,547 (1983). Thus, as long as there is a rational basis for distinguishing between digital advertising services and non-digital advertising services in this context, the tax would pass muster under the Equal Protection Clause.

First Amendment

Finally, because advertising generally qualifies as speech, I considered whether the bill raises any concerns under the First Amendment. *See Bates v. State Bar of Arizona*, 433 U.S. 350, 364 (1977). I am not aware of any cases addressing taxes that are exactly like this one; as a result, it is not entirely clear how a court would analyze the proposed tax under the First Amendment.

A threshold question in deciding whether Senate Bill 2 violates the right to free speech under the First Amendment would be whether the proposed digital advertising tax even places a constitutionally significant burden on speech in the first place or, instead, merely imposes a tax on economic conduct in the marketplace. The First Amendment protects only speech and conduct that is "inherently expressive" in nature, not pure economic conduct. *Rumsfeld v. Forum* *for Acad. & Institutional Rights, Inc.*, 547 U.S. 47, 66 (2006). The tax at issue in Senate Bill 2 is not a direct restriction or regulation of speech; it instead is a tax on revenue derived from economic activity in the marketplace. Arguably, the tax merely places a burden on the economic conduct of selling advertising services to someone else to display a message of that person's choosing or, more precisely, on the privilege of engaging in such conduct in Maryland. And that conduct, although perhaps connected to speech (i.e., advertising) in some way, might not be "inherently expressive" in and of itself. The Maryland Tax Court recently found that a Baltimore City tax imposed on billboard owners for the privilege of exhibiting outdoor advertising displays in the City burdened only conduct, not speech. *Clear Channel Outdoor, Inc. v. Department of Finance of Baltimore City*, 2018 WL 1178952, at *3 (Md. Tax Ct. 2018). Although billboards are a form of advertising, the court concluded that "[a]n excise tax imposed on the privilege of exhibiting outdoor advertising displays is a tax on the privilege of continuing in business, not on exercising free speech" and that the act of "displaying a third party's message on an outdoor advertising billboard in exchange for financial compensation lacks any significant expressive element." *Id.; see also In re Advisory Opinion to the Governor*, 509 So.2d 292, 306 (Fla. 1987) (upholding the extension of Florida's general sales tax to advertising services and, in doing so, noting that "the tax is levied upon those in the business of trafficking in first amendment expression rather than upon the exercise of the right to free speech itself"). Applying the same rationale here, the proposed tax could be characterized as a tax solely on the conduct of providing advertising services, not on speech.[2]

If a court finds that the First Amendment is implicated, a court might consider whether the tax imposes a "financial disincentive" to engage in or publish "speech of a particular content." *Simon & Schuster, Inc. v. Members of N.Y. State Crimes Victims Bd.*, 502 U.S. 105, 116 (1991). In *Simon & Schuster*, the Supreme Court struck down as unconstitutional a New York law that required a convicted criminal's income from certain works describing the crime to be deposited in an escrow account, the funds in which were then to be made available to victims of the crime if certain conditions were met. *Id.* at 109-10. The Court concluded that the law was subject to strict scrutiny under the First Amendment because it created "a financial disincentive to create or publish works with a particular content." *Id.* at 118. The court ultimately found that the law did not satisfy strict scrutiny because it was not "necessary to serve a compelling state interest" nor "narrowly drawn to achieve that end." *Id.* at 118. In reaching that conclusion, the Court also found that the constitutionality of the law did not depend on whether the "First Amendment 'speaker'" was considered to be the author of the work or the publisher because, either way, the statute "impose[d] a financial disincentive only on speech of a

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[2] The Tax Courts decision is now on appeal in the Court of Special Appeals. Oral arguments were held in December.

particular content." *Id.* at 116. Thus, assuming that the tax in Senate Bill 2 would create a financial disincentive for advertising, the question under this line of cases would be whether that is a content-based distinction.

A law is content-based under the First Amendment if it "applies to particular speech because of the topic discussed or the idea or message expressed" or if the law "cannot be justified without reference to the content of the regulated speech." *Reed v. Town of Gilbert,* 135 S. Ct. 2218, 2227 (2015) (internal quotation omitted). Under that standard, the tax here does not appear to be content-based, because it would apply to all paid advertising regardless of the subject matter discussed or the idea or message expressed. Of course, if a court were to conclude that advertising is its own "topic" of speech, the court might find that a law that applies only to "advertising" would be content-based and subject to strict scrutiny. *See Sorrell v. IMS Health Inc.,* 564 U.S. 552, 564 (2011) (categorizing "marketing" as a type of speech "with a particular content").

The term "advertising," however, at least as used in Senate Bill 2, does not refer to any particular topic of speech but rather to the act of paying to display a message on any topic or of any kind. Used in that way, it does not discriminate between different subject matters or topics of speech or even require the State to make any distinctions based on the content of the message to figure out whether it is "advertising" or some other type of speech before applying the tax. *See Lone Star Sec. & Video, Inc. v. City of Los Angeles,* 827 F.3d 1192 (9th Cir. 2016). The Court in *Lone Star* concluded that a law regulating the use of mobile billboard advertising was not content-based because "the word 'advertising'" merely "refers to the activity of displaying a message to the public, not to any particular content that may be displayed" and "an officer seeking to enforce the non-motorized billboard ordinances must decide only whether an offending vehicle constitutes a prohibited 'advertising display' because its primary purpose is to display messages, as opposed to transporting passengers or carrying cargo." *Id.* at 1199-1200.

Second, if a court finds that Senate Bill 2 applies to economic conduct but has an incidental effect on speech (or on conduct that is "inherently expressive"), then it might analyze the tax under the test established in *United States v. O'Brien,* 391 U.S. 367 (1968). The *O'Brien* test is a form of intermediate scrutiny applicable to content-neutral restrictions aimed at conduct that may nonetheless involve "incidental" burdens on First Amendment freedoms. *Id.* at 376-77. Under that test, a law will pass muster if it is within the constitutional power of the government, furthers a substantial government interest that interest is unrelated to the suppression of protected expression, and any incidental restrictions imposed on protected expression are no greater than essential to further the interest. *Id.* The last prong of the test, despite its facial similarity to the test for strict scrutiny, does not require the restriction in question to be the least restrictive means of advancing the government's interest. *Rumsfeld,* 547 U.S. at 67. Instead, it merely requires that "the neutral regulation promotes a substantial government interest that would be achieved less effectively absent the regulation." *Id.* (quoting *United States v. Albertini,* 472 U.S. 675, 689 (1985)).

If a court were to apply the *O'Brien* test, Senate Bill 2 would not be clearly unconstitutional. The proposed tax is within the constitutional power of the State. The State also has a substantial interest in raising revenue for education. Although the Supreme Court has said that raising revenue, standing alone, is not a "compelling" government interest that can support a content-based distinction under the strict scrutiny test, it would likely qualify as a "substantial" interest for purposes of intermediate scrutiny. *See Arkansas Writers' Project, Inc. v. Ragland,* 481 U.S. 221, 231 (1987) (characterizing the interest in raising revenue as "important"); *Astra Limousine Serv., Inc. v. Hillsborough County Aviation Auth.,* 678 F. Supp. 1561, 1565 (M.D. Fla.), *aff'd sub nom. Astra Limousine v. Hillsborough,* 862 F.2d 877 (11th Cir. 1988) ("Revenue-raising is undoubtedly a legitimate and substantial government objective."); Nebraska Op. Att'y Gen. No. 03015, 2003 WL 21540493 (May 14, 2003) (concluding that a proposed tax on revenue from casino advertising served a substantial government interest for purposes of the test for restrictions on commercial speech, which has a similar requirement that the law serve a substantial government interest). That interest is also unrelated to the suppression of protected expression.

The remaining question under *O'Brien* would be whether the tax "promotes a substantial government interest that would be achieved less effectively absent the regulation." *Rumsfeld,* 547 U.S. at 67 (internal quotation omitted). Although the proposed tax would not be the least restrictive means to raise revenue for education, the tax need not be the least restrictive means of achieving the government's goal to satisfy this requirement. *See id.; see also Bushco v. Utah State Tax Comm'n,* 225 P.3d 153, 168 (Utah 2009) (concluding that the least restrictive means test did not apply under *O'Brien* and upholding a tax on the gross receipts of businesses whose employees perform services while nude or partially nude for 30 days or more per year); *Adams Outdoor Advertising, Ltd. v. Borough of Stroudsburg,* 667 A.2d 21 (Pa. Comm. Ct. 1995) (upholding a tax on billboards under a similar form of intermediate scrutiny). Thus, the tax is not "invalid simply because there is some imaginable alternative that might be less burdensome on speech." *Bushco,* 225 P.3d at 168 (quoting *Albertini,* 472 U.S. at 689). Instead, the tax is permissible so long as it is "narrowly tailor[ed]" to the government's objective, that is, if "the means chosen do not burden substantially more speech than is necessary to further" the government's interest. *Turner Broad. Sys., Inc. v. F.C.C.,* 512 U.S. 622, 662 (1994) (internal quotation marks omitted).

Under that standard, a strong argument can be made that Senate Bill 2 would not burden substantially more speech than necessary to serve the State's substantial interest in raising revenue for education. The actual burden on speech here, if any, would likely be minimal. The tax does not prohibit or restrict any speech, and it does preclude the earning of revenue by selling advertising space to others; it merely taxes that revenue. To be sure, there is some authority under the similar "narrow tailoring" test that applies to commercial speech that a tax must be sufficiently "general" in nature to satisfy this prong, i.e., that it must apply to enough economic conduct so as to avoid disproportionate burdens on First Amendment expression. *See* Nebraska Op. Att'y Gen. No. 03015 (finding that a tax on casino advertising was not narrowly tailored because it could have applied more broadly to avoid disproportionate impact on a particular topic of speech). But the proposed tax here is more general than the one in Nebraska in that it applies to the revenue from all digital advertising, not just one particular topic of advertising. *See* Nebraska Op. Att'y Gen. No. 03015 (leaving open whether a tax on all advertising would be permissible).

In addition, a court might consider whether the bill impermissibly discriminates among speakers by imposing a tax on the revenue from digital advertising but not on other forms of advertising, such as print or broadcast advertising. There is a well-established doctrine for evaluating the constitutionality of tax laws that draw distinctions among particular speakers. *See Leathers,* 499 U.S. at 447; *Arkansas Writers' Project*, 481 U.S. at 227-31; *Minneapolis Star & Tribune Co. v. Minnesota Comm 'r of Revenue,* 460 U.S. 575 (1983); *Grosjean v. American Press Co.,* 297 U.S. 233 (1936). Under that doctrine, "differential taxation of First Amendment speakers is constitutionally suspect" only "when it threatens to suppress the expression of particular ideas or viewpoints." *Leathers,* 499 U.S. at 447. And that threat arises only when the tax (1) singles out the press, (2) targets a small group of speakers, or (3) discriminates on the basis of the content of taxpayer speech. *Id.* It is unlikely that a court would find Senate Bill 2 runs afoul of this doctrine.

The proposed tax does not single out the press. Press entities may of course be affected if they provide digital advertising services and otherwise meet the revenue thresholds set forth in the bill. The tax, however, would also apply to a broad array of other entities that provide digital advertising services. Although the Maryland Court of Appeals in 1958 struck down a Baltimore City tax on the sale of advertising space in newspapers and certain other media on the ground that the tax disproportionately burdened the press, *see City of Baltimore v. A.S. Abell Co.,* 218 Md. 273 (1958), the tax proposed by Senate Bill 2 is distinguishable. In *Abell,* Baltimore City imposed two related taxes: (1) a sales tax on advertisers for the purchase of advertising space in "all newspapers, magazines, periodicals, programs, directories and other printed matter published in Baltimore" and on "any intrastate radio or television broadcast originating in the City of Baltimore and directed to persons in the State of Maryland" and (2) a gross receipts tax on the revenues earned by the sellers of that same advertising space. *Id.* at 277-78. In practice, however, between 90 and 95 percent of the burden of the taxes fell on newspapers, radio stations, and television stations, i.e., the press. *Id.* at 288. Given that disproportionate burden on the press, the Court held that the taxes violated the First Amendment by singling out the press for a special burden not borne by other types of businesses. *Id.* at 288-89.

The Court in that case also explained, however, that a "general" tax would have to be permissible, even if it would have an incidental effect on the press. *Id.* at 287-88. It thus left open the question of whether it would have been permissible to impose a tax on the entire advertising industry, such that the press would not be singled out, and declined to "delineate the exact boundaries" of what would constitute a "general tax." *Id.* Here, unlike in *Abell,* the proposed tax would apply broadly to all digital advertising services, not just those that are likely to impose a special and highly disproportionate burden on the press. Thus, in contrast to the tax in *Abell,* it is unlikely that the tax in Senate Bill 2 would impose the same kind of disproportionate burden on the press.

Similarly, the proposed tax does not seem to target a small group of speakers such that it would "threaten[] to suppress the expression of particular ideas or viewpoints." *Leathers,* 499 U.S. at 447. The tax, would apply to the revenue from the sales of all digital advertising space by all entities that sell such digital advertising space in Maryland (or at least all of those entities that do a certain amount of business above a certain threshold). Although the tax applies only to digital advertising, that distinction seems unlikely to target a small group of speakers.

Finally, the tax does not seem to discriminate among speakers on the basis of the content of the taxpayer's speech. As noted above, the tax applies to revenue from all sales of digital advertising services, regardless of the specific purpose of the advertising, the topic addressed in the advertising, or the message expressed by the advertising.

It is possible, however, that a court could conclude that unlike a typical sales tax or gross receipts tax that might apply to a broad array of economic conduct, including advertising services, the tax in Senate Bill 2 applies exclusively to revenue derived in connection with a form of speech, i.e., advertising. In that sense, one could argue that Senate Bill 2 "singles out" a First Amendment interest for a special tax. *See Vermont Soc. of Ass'n Executives v. Milne,* 779 A.2d 20 (Vt. 2001) (striking down a tax on lobbyists); *Lamar Advantage GP Co. v. City of Cincinnati,* 114 N.E.3d 805 (Ohio Ct. Comm. Pleas 2018) (striking down a tax on billboards because, among other reasons, it viewed the tax as a "direct tax[] upon the exercise of constitutional rights or upon the means or instruments by which such rights are exercised") (on appeal).

I note, however, the Supreme Court concluded a law may be sufficiently "general" for purposes of the First Amendment when it applies to a wide enough array of speakers that the government cannot use the tax as a tool to penalize particular speakers for their ideas or viewpoints. *See Leathers,* 499 U.S. at 449 (finding that a tax that applied to a "large number of cable operators offering a wide variety of programming" did not pose a risk of censorship); *see also Minneapolis Star & Tribune Co.,* 460 U.S. at 585 (explaining that, "[w]hen the State imposes a generally applicable tax, there is little cause for concern" because there is "no fear that a government will destroy a selected group of taxpayers by burdensome taxation if it must impose the same burden on the rest of its constituency"). The proposed digital advertising tax (at least on its face) does not seem to target such a small group of speakers that it would pose that risk of censorship based on particular ideas or viewpoints.[3]

Conclusion

In the final analysis, although there is some risk that a court would determine Senate Bill 2 to be invalid on constitutional grounds, I do not conclude that it is clearly unconstitutional.

Sincerely,

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[3] A safe harbor to avoid any risk of a First Amendment issue would be to include a tax on digital advertising services as part of a more broadly applicable gross receipts or sales tax on a wider array of goods and/or services. *See In re Advisory Opinion to the Governor,* 509 So.2d at 306 (upholding the extension of Florida's sales tax on services to advertising services in part because "the tax is one of general application and does not single out advertisers or the press for special taxation"); *Lee Enterps., Inc. v. Iowa State Tax Comm'n,* 162 N.W.2d 730, 755 (Iowa 1968) (upholding amendment to Iowa's sales-and-use tax to include tax on advertising because it was part of a tax scheme of "general application").