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Maryland: Tax on digital advertising services is enacted

Maryland's legislature on February 12, 2021, voted to override the governor's veto of legislation imposing a new tax on digital advertising. Accordingly, the digital advertising services tax measures are enacted and effective for tax years beginning after December 31, 2020.

KPMG observation

Maryland is the first state to adopt a specific tax on the revenues derived from digital advertising. However, there are similar proposals under consideration in Connecticut, Indiana, Montana, and New York.

House Bill 732

House Bill 732 imposes a new tax on the gross revenues of a person derived from digital advertising services in Maryland.

- "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."

- "Digital interface" means any type of software, including a website, or application that a user is able to access.

- The "assessable base" for the tax is defined as the annual gross revenues derived from digital advertising services in the state.

- Digital advertising service revenues are sourced to Maryland using an apportionment factor that is based on annual gross revenues derived from digital advertising services in Maryland over the taxpayer's annual gross revenues derived from digital advertising services in the United States.

House Bill 732 does not provide guidance on how a taxpayer determines which state digital advertising service revenues are attributed to. The Comptroller is directed to adopt regulations to provide how this will be determined.

The tax applies to persons that have:

- Global annual gross revenues of $100 million or more; and
- Digital advertising revenues sourced to Maryland of $1 million or more.

The rate of tax is determined based on the person's global annual gross revenues.

- For persons with global annual gross revenues of $100 million through $1 billion, the tax rate is 2.5% of the assessable base.
- For persons with global annual gross revenues of over $1 billion through $5 billion, the tax rate is 5.0% of the assessable base.
- For persons with global annual gross revenues of over $5 billion through $15 billion, the tax rate is 7.5% of the assessable base.
- Persons with over $15 billion of global annual gross revenues will pay the tax at a 10% rate.

Every person subject to the tax that is expected to have annual gross revenues from digital advertising services in Maryland of over $1 million is required to file an annual declaration of estimated tax and make quarterly estimated tax payments.

Background

House Bill 732 providing the new tax on digital advertising gross revenues was approved in March 2020 shortly before the General Assembly adjourned.

The governor subsequently vetoed the bill, citing concerns about imposing new taxes on businesses in the midst of the coronavirus (COVID-19) pandemic. The Maryland Senate joined the House of Delegates and voted on February 12, 2021, to override the governor's veto. As such, House Bill 732 is now law in Maryland, and the new digital advertising services tax is effective for tax years beginning after December 31, 2020.

Technical corrections to House Bill 732

Two "cross-filed bills"—Senate Bill 787 and House Bill 1200—have been proposed that would adopt certain technical corrections to House Bill 732.

- These bills would narrow the definition of "digital advertising services" to exclude "advertisement services on digital interfaces owned or operated by or operated on behalf of a broadcast entity or news media entity."

- The bills would define "broadcast entity" to include "any entity primarily engaged in the business of operating a broadcast television or radio station."

- "News media entity" would be defined to include "any entity primarily engaged in the business of newsgathering, reporting, or publishing articles or commentary about news, current events, culture, or other matters of public interest."

- The definition of "news media entity" would specifically exclude those who primarily republish third-party content.

The bills also include a provision prohibiting persons subject to the digital advertising tax from directly passing the cost of the tax onto their customers by means of a separate fee, surcharge or line-item.

A hearing is scheduled for Senate Bill 787 on February 17, 2021, and a hearing on House Bill 1200 is scheduled for February 26, 2021.

KPMG observation

Maryland is the first state in the United States to adopt a tax on digital advertising services. Opponents of the measure have raised several potential challenges to the tax, including that the tax would violate the "permanent" Internet Tax Freedom Act (ITFA). The ITFA prohibits states and localities from imposing multiple or discriminatory taxes on electronic commerce. A "discriminatory tax" includes a tax imposed by a state or local subdivision thereof on electronic commerce that "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." Because Maryland does not impose tax on traditional advertising services, the new tax potentially violates the ITFA's prohibition against discriminatory taxes.

Opponents of the measure have also noted that in addition to failing to provide guidance on how digital advertising revenues will be attributed to any particular state, the definitions in the bill are overly vague and unworkable. Observers believe it is almost certain that legal challenges to the new digital advertising tax will be filed in the near future.

Because the tax is effective for tax years beginning after December 31, 2020, businesses generating revenues from digital advertising need to consider the following: (1) are they a person subject the tax; (2) do they have the requisite revenues from digital advertising attributed to Maryland (absent clear guidance as to how this determination is made); (3) does the "person" with the digital advertising revenues have the requisite global annual revenues; and (4) is there more than one person that may be subject to tax on certain digital advertising revenues (e.g., website or app owner, ad networks or brokers). Companies need to continue to monitor and consider any legal challenges filed in response to House Bill 732.

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