As seen in *The Agency 100*

APRIL 20, 2021

LEGAL

STATES SEEK TO TAX DIGITAL ADVERTISING REVENUE

The economic impact of COVID-19 cannot be understated. States have experienced significant budget shortfalls due to limited economic activity, and as a result, state legislatures are searching for ways to raise revenue. Several states are looking into ways to close the budget gap by taxing digital advertising and one state — Maryland — has just enacted a law to that affect.

The Maryland Law

On Feb. 22, 2021, the Maryland legislature overrode a veto by the governor to enact the nation's first tax on annual gross revenue from digital advertising services. The Maryland act (the "Act") requires "persons" to pay a tax on annual gross revenues of such person derived from digital advertising in the state of Maryland." However, due to vague drafting, who must pay — and how much — remains uncertain in many cases.

The Act imposes a graduated tax, beginning at 2.5% and capped at 10% (depending on global gross revenue from all sources) on the annual gross revenue of businesses derived from "digital advertising services" conducted in Maryland. Though the definition of "digital advertising services" is open-ended, the tax is designed to target large digital platforms such as Google, Amazon and Facebook. The Act provides that it "includes" (but presumably is not

ABOUT THE AUTHORS

Michael C. Lasky is Founder and Chair of the Public Relations Law Practice Group of Davis+Gilbert LLP.

He may be reached at mlasky@dglaw.com or 212 468 4849

Derick D. Dailey is an Associate in the Litigation Practice Group of Davis+Gilbert LLP.

He may be reached at ddailey@dglaw.com or 212 237 1460

limited to) banner advertisements, search engine advertising and other forms of advertising, but how far this definition could extend beyond the items it "includes" is unclear.

The Act provides no detail on apportionment to Maryland. The Act directs the Maryland Comptroller to issue more rules addressing this issue, but delineating the source of revenue from digital advertisements will be difficult. Furthermore, the law is vague as to what it means for revenue to be "derived from" digital advertising services, and it is unclear whether the fees paid to advertising brokers, advertising companies, designers, agents and other intermediaries may be subject to the tax. Combined with a lack of a "sale for resale" exemption typically incorporated in state sales tax regimes, this means that the Act could result in tax being assessed multiple times for the same overall transaction.

Pursuant to several amendments, which passed the Maryland legislature on April 12, the Act's effective date is Jan. 1, 2022, broadcasters and news media entities are exempted from the tax, and companies subject to the tax cannot pass the cost of the tax on to their customers.

Days after the Act became law, the U.S. Chamber of Commerce and several industry groups started a lawsuit against the state of Maryland. Plaintiffs argue that the law discriminately imposes penalties on electronic commerce and out-of-state conduct. Specifically, the plaintiffs allege that the new law (1) imposes multiple and discriminatory taxes on electronic commerce; (2) interferes with interstate commerce and violates the Due Process Clause and Commerce Clause of the Fourteenth Amendment because the law disproportionately penalizes out-of-state conduct, and (3) infringes on freedom of speech, in violation of the First Amendment. The plaintiffs are seeking a declaration that the Act is unconstitutional and further request that the Act be enjoined from enforcement. The court is expected to rule on the legality of this Act later this year.

Several other states have pending legislation, of one type or another, seeking to capture revenue from digital advertising and data collection activities. Here are just five of the states with proposed legislation:

New York

Several bills that would subject digital advertising services to tax are pending in the New York Assembly. One, S.1124 takes a similar approach to the Maryland Act, being a stand-alone tax not part of the state's sales tax. The other, A.734, extends the New York State sales tax to "digital advertising services." Both bills are vague as to the key sourcing and application questions that also troubles the Maryland Act.

Another bill, S.4959, would impose a "monthly excise tax on the collection of the consumer data of individual New York consumers by commercial data collectors." This tax would apply regardless of the use (if any) to which the data was put, whether it is re-sold or used by the collecting entity in its own business. As such, the bill may perversely provide an incentive for all data collectors to monetize the data they collect data to fund the payment of the tax.

Connecticut

An omnibus bill (Proposed Bill 6187 in the General Legislature) proposes that the state "establish a 10% tax on the annual gross revenues derived from digital advertising services in the state for any business with world-wide annual gross revenues exceeding ten billion dollars." No detailed legislation effectuating this intent has yet been proposed.

Massachusetts

Currently, three bills are pending relating to this issue. The first, H. 3358 would simply establish a commission to examine the issue. The second, H. 3210, is similar to the Maryland Act. The third, H. 3601, is similar to H. 3210 except that, unlike the Maryland Act, it imposes a flat rate of tax rather than a graduated one.

Oregon

H.B. 2392 proposes to impose a 5% gross receipts tax on businesses that generate revenue from selling the taxable personal information of individuals in Oregon. The tax applies to personal information accumulated from individuals' IP addresses located in Oregon.

Indiana

In contrast to the limited nature of the Maryland law, the proposed law in Indiana (H.B. 1312) proposes to place a surcharge tax on certain social media providers. The tax would be paid by providers who have more than 1 million active Indiana account holders and at least $1 million in annual gross revenue derived from social media advertising services in Indiana.

The Bottom Line

- If Maryland is successful in court, other states may very well be emboldened to seek to replicate the Maryland law in their states.
- Even if the Maryland law is not upheld, other states are looking at alternative ways to collect revenue from digital advertising and marketing services. The proposals in other states bear close watch and we will be continuing to monitor and report on these developments.