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# What Will Come of Maryland's Unique and Controversial Digital Advertising Tax?

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On February 12, 2021, overriding the Governor's veto, Maryland enacted a first-of-its-kind tax "Digital Advertising Gross Revenues Tax" that has already sent shockwaves through the industry. As widely anticipated, within one week of the enactment four trade associations representing industry leaders filed suit in Maryland federal court to attempt to overturn the tax.

## What is the New Digital Advertising Services Tax?

The new law, H.B. 732, imposes a tax up to 10 percent on gross revenue from digital advertising services placed by large digital advertisers, such as Facebook and Google, in Maryland. The law imposes a graduated tax which exempts smaller businesses whose gross annual revenues are less than \$100 million. The graduated tax applies as follows:

- 5 percent of the assessable base if global annual gross revenue is between \$100 million and \$1 billion;
- 5 percent of the assessable base if global annual gross revenue is between \$1 billion and \$5 billion;
- 5 percent of the assessable base if global annual gross revenue is between \$5 billion and \$15 billion; and

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- 10 percent of the assessable base if global annual gross revenue is above \$15 billion.

“Digital advertising services” is broadly defined to include advertising services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services. A digital interface means any type of software, website, or application that a user can access.

The new tax is effective for all taxable years after December 31, 2020, and thus it is *retroactive* to January 1<sup>st</sup>, should it actually survive legal challenges. Notably, the law also provides for potential criminal penalties for willful failure to file a return.

### What are Digital Advertising Services “in the State?”

One critical open question is what actually constitutes digital advertising “*in the state*.” The law lacks any sourcing provision and instead delegates to the Comptroller, the authority to determine from which state revenues from digital advertising services are derived. The Comptroller however has yet to release any guidance on sourcing notwithstanding the fact that this novel law is retro to January 1<sup>st</sup> and there are criminal penalties for failing to file a return.

It also remains to be seen how the state will tax the digital advertising services when there are multiple advertisers (in multiple states) in the chain of one digital transaction.

### What is the Basis of the Lawsuit filed in Maryland Federal Court?

The recently filed lawsuit, *Chamber of Commerce v. Franchot*, alleges that the new law is discriminatory and violates the Internet Tax Freedom Act (ITFA),

which prohibits the imposition of discriminatory taxes on electronic commerce where a similar tax does not apply to print or other media. The complaint argues that because the law provides only for a tax on digital advertising and exempts other forms of advertising (e.g., print, radio or television), it violates the ITFA.

The suit also challenges the Maryland law as unconstitutional because it violates both the commerce and due process clauses of the U.S. Constitution. The basis of these claims is that it burdens out-of-state online companies for activities occurring outside Maryland.

While the filing of the lawsuit was unsurprising, it remains to be seen what will come of Maryland's newly enacted digital advertising tax. The rest of the country will be following Maryland closely, as several other states have recently considered similar measures and the decision could have a cascading effect on other state legislatures.

### Other Issues to Watch

In an effort to ensure that only the large digital advertisers pay the tax and not Maryland residents, there is also a companion bill that would seek to ban such companies from directly passing along the cost of the tax (e.g., separate fee, surcharge or line item) to businesses that pay to advertise on such sites. Of course, this is really a meaningless gesture since such sellers would likely just increase the price of the ads in Maryland and not separately break out the tax, should such legislation pass.

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