



American Advertising Federation of Baltimore  
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January 15, 2020

Senate President Bill Ferguson, SB 2 Co-Sponsor  
Senator Thomas V. Mike Miller, Jr., SB 2 Co-Sponsor  
Senator Guy Guzzone, Chair, Budget and Taxation Committee  
Senator Jim Rosapepe, Vice Chair, Budget and Taxation Committee  
Members of the Budget and Taxation Committee

**Re: Opposition to SB 2 – Tax on Digital Advertising**

Dear Senate President Ferguson, Senator Miller, and Members of the Budget and Taxation Committee:

On Wednesday January 8, 2020, former Senate President Thomas V. Mike Miller Jr. and current Senate President William “Bill” Ferguson sponsored Senate Bill 2 (“SB 2”), titled “Digital Advertising Gross Revenues – Taxation.” SB 2 intends to impose:

a tax on annual gross revenues derived from digital advertising services including advertisement services on a digital interface in the State; establishing a presumption that digital advertising services are provided in the State if the digital advertising services appear on a certain device of a certain user; requiring the Comptroller to distribute digital advertising gross revenues tax revenue to administer certain tax laws and the remainder to be distributed to The Blueprint for Maryland's Future Fund; etc.

The American Advertising Federation of Baltimore, in partnership with AAF National, have strong concerns regarding the imposition of taxes on digital advertising services as proposed in SB 2. Briefly, the proposed tax is a gross receipts tax. The Digital Goods and Services Coalition has provided the following analysis and predictions of issues that this proposed tax:

*Introduction/Background*

- **Uncharted New Tax on Digital Advertising Services:** If enacted by SB 2, Maryland would become the first state or locality in the United States to impose a targeted punitive tax on the gross revenue of digital advertising services. While no state taxes advertising revenue in the manner and extent proposed by SB 2 (primarily due to the constitutional and policy concerns outlined below), only two states tax advertising services under their generally applicable broad-based transaction tax (not a gross receipts tax such as the tax proposed by SB 2). Contradicting the clear legislative trend in the advertising space to exempt the facilitation of advertising services (but tax the consumer transactions that may result therefrom), SB 2 would impose a new one-of-a-kind tax on the annual gross revenue of

digital advertising services that are deemed to be provided in the State. The proposed tax contains a tiered tax rate structure (arbitrarily determined based on the advertising service provider's *global* annual gross revenues) that would allow for up to a whopping tax of 10% of the annual gross revenue in the State derived from digital advertising services. As introduced, SB 2 would take effect July 1, 2020 and apply to all taxable years beginning after December 31, 2020.

### *Constitutional Concerns*

- **Violates Federal Law:** The Permanent Internet Tax Freedom Act (“PITFA”) enacted by Congress prohibits states from imposing “discriminatory taxes on electronic commerce.” See 47 U.S.C. § 151, *note*. The federal law defines “discriminatory tax” as “any tax imposed by a State . . . on electronic commerce that (i) is not generally imposed and legally collectible by such State . . . 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 . . . on transactions involving similar property, goods, services, or information accomplished through other means . . . [or] (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.” *Id.* at § 1105(2)(A). The digital advertising tax proposed by SB 2 would result in a prohibited discriminatory tax on electronic commerce in violation of PITFA. For example, the new digital advertising services tax created by SB 2 would discriminate against digital advertising service providers because Maryland does not also tax service providers of non-digital advertising. Even if similar advertising services are alleged to be subject to the Maryland sales tax, differences in rate or incidence of the tax would independently still result in a “discriminatory tax” in violation of federal law. Because the digital advertising service tax proposal is predominantly imposed on remote advertisers that are implicated due to the ability of an end user to access the advertising material located on the company’s out-of-State server, this provides a separate independent basis to show that the digital advertising service tax is a “discriminatory tax” prohibited by federal law. These are just a few discrete examples of the potential PITFA violations created by SB 2. Because PITFA is a federal law, it must be respected by Maryland under the Supremacy Clause of the U.S. Constitution and if Maryland were to move forward with SB 2 it would likely be struck down by the federal courts—after costly and unnecessary litigation. In the long term, the enactment of this law would not create a stable revenue stream to bolster Maryland education funding and would potentially result in a net loss to the state coffers.
- **Discriminates Against Interstate and Foreign Commerce:** SB 2 would impose the punitive digital advertising gross revenues tax only on large companies based on an arbitrary threshold of *global* annual gross revenues. The larger and more global the company, the higher the tax rate. While this may be politically popular—taxing out-of-state and foreign companies more heavily than in-state businesses is constitutionally suspect under the dormant Commerce Clause. A long history of federal cases have struck down efforts by states and local governments to use extraterritorial receipts to discriminate against interstate businesses and in favor of hometown businesses. This is exactly what the digital advertising gross revenues tax proposed to do – by taxing larger global advertising service providers at a higher tax rate than their domestic counterparts with the exact same gross revenue attributable to Maryland. The Commerce Clause of the U.S. Constitution protects companies from taxes such as the SB 2 digital advertising gross revenues tax and is yet

another example of the ripeness of litigation should the tax proposal advance without a substantial overhaul. These constitutional limitations do not appear to have been considered and collection of the proposed tax could once again put Maryland in the position of having to refund an illegal tax—a process it went through recently when one of its taxes was declared unconstitutional by the U.S. Supreme Court.

- **Additional Constitutional Concerns:** The punitive digital advertising gross revenues tax doesn't stop there in terms of potential constitutional oversteps. For example, the digital advertising gross revenues tax may violate the Equal Protection Clause of the U.S. Constitution due to a lack of a rational basis for discriminating against advertising services provided on a digital interface—since the law does not impose the same punitive treatment on advertising services that are not on a digital interface. The proposed digital advertising service gross revenue tax also raises significant First Amendment concerns due to the fact that the tax would in effect regulate commercial speech by forcing just *digital* advertising service providers in Maryland to either cease allowing Maryland customers to view ads or substantially increase fees they charge companies advertising on their platform against their will (to account for the loss they would otherwise obtain from the punitive digital advertising services tax). For example, the Maryland Court of Appeals has held that municipal taxes on advertising media were unconstitutional for singling out for taxation newspapers and radio and television stations entitled to first amendment immunities. See *City of Baltimore v. A.S. Abell Co.*, 218 Md. 273, 145 A.2d 111 (1958). The same constitutional concerns that the court found in that case apply here—just in the context of digital advertising.

#### *Policy Concerns*

- **New Tax Will Hurt Maryland Companies and Residents:** The economic burden of this broad new tax will fall on Maryland residents and Maryland businesses that are consumers of advertising services within a digital interface—including websites and applications. This is because advertising service providers may (and most likely would) pass the tax through to their customers (including local Maryland brick and mortar businesses seeking to reach new customers online), who will be forced to pay higher prices, receive lower revenues, or find cheaper alternatives. While on the surface the tax appears to fall only on large non-resident Internet advertising providers, this new tax initially will fall on Maryland advertisers through increased prices of up to 10% on Internet-based advertising. Eventually, the tax will fall on Maryland consumers who will suffer higher prices for goods and services they purchase from the companies advertising on the digital interface.
- **Similar Proposals Have Failed Historically:** Arizona, Iowa, and Florida each passed broad advertising taxes years ago. Each state later repealed the tax because it hurt their local economy and was impossible to administer. Since 1987, when the Florida services tax was repealed, broad advertising taxes have been considered in more than 40 states and rejected in every instance.
- **Pyramiding and Multiple Taxation Would Result:** Pyramiding occurs when a tax is imposed on business services at the intermediate level, rather than being imposed only on final purchase of the product by consumers (as a sales and use tax is). Advertising is not an end product. Rather, advertising is a communications process that helps produce the final sale of a product, which is most likely already subject to the state sales tax. Since a

portion of any tax on the intermediate advertising process is likely to be passed along to consumers, there would be at least double taxation for most products or services purchased in the state if SB 2 is enacted.

- **Costly to Administer:** An advertising tax such as the tax proposed by SB 2 would create a huge new administrative burden on state government. Digital advertising is a very complex area, involving millions of ads placed across a litany of digital platforms. The Comptroller would likely need to hire new staff and engage an army of accountants and lawyers to administer and enforce the proposed new tax.

Based on the concerns we've outlined, the undersigned strongly oppose SB 2 and ask the Budget and Taxation committee to remove the bill from further consideration. We appreciate your attention to this matter and look forward to exploring ways in which our industry can support Maryland without crippling our competitive and economic prospects.

Best regards,

A handwritten signature in black ink, appearing to read 'Matthew McDermott', with a horizontal line extending to the right.

Matthew McDermott, President, AAF Baltimore;  
The Board of Directors, AAF Baltimore;  
The Members of the American Advertising Federation of Baltimore; and  
Clark Rector, Executive Vice President-Government Affairs, American Advertising Federation