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CLIENT ALERT

Maryland's Digital Advertising Tax: A Contentious Start, and an Uncertain Future

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Maryland became the first U.S. state to create a digital advertising tax on February 12, 2021. The Digital Advertising Gross Revenue Tax (DAGRT) was originally passed in March of 2020, but subsequently vetoed by Maryland Governor, Larry Hogan. Maryland's legislature voted to override the Governor's veto, however. The contentious journey for DAGRT passage is likely to be overshadowed by a litigious future.

DAGRT (full text here) imposes a progressive tax on the sale of digital advertising services' gross revenue within the state. DAGRT focuses on large providers of digital advertising services; entities with revenue exceeding $100 million. The rate of the tax imposed, based on global revenue, is 2.5% for annual global gross receipts of $100 million to $1 billion, 5% for gross receipts of $1 billion to $5 billion, 7.5% for gross receipts of $5 billion to $15 billion, and 10% for gross receipts exceeding $15 billion. The rate then applies to digital advertising services' gross revenue in Maryland. However, DAGRT does require all entities with an annual gross revenue derived from digital advertising services within the state over $1 million to file a specialized tax return. DAGRT's focus on large providers of digital advertising services might incentivize these providers to find avenues to avoid the tax by changing their digital advertising strategies. For example, more companies may offer advertisement-free subscription options. It's also possible that the companies faced with paying the tax may simply pass the cost on to the smaller businesses purchasing the advertisements and to consumers.

DAGRT has an uncertain future and has been criticized by its opponents as vague, unfair, discriminatory, and unconstitutional. In fact, the tax already faces immediate challenge: technology lobbying groups filed a complaint on February 17, 2021—less than one week after the Maryland legislature voted to override the governor's veto—challenging DAGRT under the Internet Tax Freedom Act, which prohibits discrimination against electronic commerce, and under the Due Process Clause and Commerce Clause of the U.S. Constitution. *Chamber of Com. v. Franchot*, Civ. No. 21-cv-410 (N.D. Md. filed Feb. 18, 2021). The complaint criticizes the punitive character, focus on out-of-state conduct, and whether DAGRT is even a tax. DAGRT has punitive character because the tax is applicable to gross, not net, revenue, can range up to 10% of net revenue, and the legislative history suggests large tech companies are the specific target. DAGRT's tiered assessment rates are based on global gross receipts, thus the extent of an entity's liability depends on out-of-state conduct.

Most practically, the vagueness of the tax has entities questioning logistical implementation of the requirements and responsibilities imposed by the bill. DAGRT taxes gross revenue from "digital advertising services" defined as "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services." Although digital advertising services is defined, this non-exhaustive list creates a vague scope of the types of digital advertising that would be included. As enacted, DAGRT creates tax obligations for the current year and, without further guidance from the state comptroller, affected entities will have difficulty in accurately completing their new tax obligations.

DAGRT originated during a moment of fiscal uncertainty for state governments and revenue prowess for large technology companies, largely due to the COVID–19 pandemic. Specifically, the reallocation of state government budgets in an attempt to combat health and economic concerns and the exacerbated reliance on technologically driven economies have led to a climate where state authorities may focus on large technology companies to help manage budgetary shortfalls. For example, DAGRT is predicted to generate up to $250 million in revenue for Maryland within its first year.

In addition to Maryland's bill, other states are considering imposing digital advertising taxes. New York (AB 10706) Connecticut (HB 6187) and Indiana (HB 1312) have proposed similar bills.

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