

Alert | State & Local Tax (SALT)



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Maryland’s Digital Advertising Tax Defeated

A Maryland circuit court judge has struck down Maryland’s first-in-the-nation digital advertising tax (“Digital Ad Tax”). On Oct. 17, 2021, ruling from the bench, the judge held that the law violates the federal Internet Tax Freedom Act (ITFA), the Commerce Clause of the U.S. Constitution, and the First Amendment. This GT Alert provides some observations on this consequential taxpayer victory.

1. The Decision is Unsurprising, but Significant

In 2020 the Maryland General Assembly passed laws that allowed Maryland to become the first state in the nation to impose a tax on revenues that certain businesses derive from providing advertising services on a digital interface, including banner advertising, search engine advertising, interstitial advertising and other comparable advertising services (“digital advertising services”).¹ In 2021, the Maryland General Assembly amended the Digital Ad Tax, notably by adding a provision that prohibited businesses from directly passing on the cost of the tax to customers through a separate fee, surcharge, or line item and exempting certain advertising service providers.

Indeed, some tax practitioners opined that the Digital Ad Tax, as enacted, would be found void and unenforceable, chiefly because the tax was a clear violation of the ITFA.² In 1998, Congress enacted the ITFA to prohibit state and local governments from, among other things, imposing “multiple or

¹ Md. Code Ann. Tax-Gen § 7.5-101(D).

² See e.g., [Maryland State Bar Association Section of Taxation Testimony](#), Jan. 29, 2020.

discriminatory taxes on electronic commerce.”³ The ITFA specifically defines what constitutes a “discriminatory tax.” “Discriminatory tax” is defined to include “any tax imposed by a State . . . on electronic commerce that . . . is not generally imposed and legally collectible by such State . . . on transactions involving similar property, goods, services, or information accomplished through other means. . . .”⁴ “Electronic commerce” is defined as “any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information. . . .”⁵ Given the above, an illegal discriminatory tax is one imposed on electronic commerce that is not generally imposed on transactions involving similar services accomplished through other means.

Once enacted in 2021, the Digital Ad Tax was challenged at the federal and state level.⁶ Both cases challenged the tax on the basis that it violated the ITFA, the Commerce Clause, and the Due Process Clause. A federal judge’s dismissal of a substantial challenge – that the tax violated the ITFA – meant that much rode on the state-level ITFA challenge to the Digital Ad Tax.

Although the Anne Arundel Circuit Court judge’s Oct. 17 decision may have expedited the destiny of the Digital Ad Tax, the Comptroller may well appeal the decision to the Maryland Court of Special Appeals, Maryland’s second highest court. This is in part because, although the Digital Ad Tax is only intended to be imposed on a limited number of businesses, the legal impact of this case transcends the taxation of digital advertising. The case has implications for how far states can seek to expand their tax bases to include certain types of electronic commerce while considering ITFA restraints.

2. Maryland’s Digital Ad Tax Served as a (Faulty) Blueprint for Other States

Thus far, Maryland’s Digital Ad Tax served as a model for other states to consider. This is surprising considering the plethora of non-ITFA related issues that also plagued the law. But in evaluating the circumstances under which the tax was born, it seems clear Maryland’s law was not the ideal one to serve as a nationwide model.

2020 was poised to be the year of the Kirwan Commission on Innovation and Excellence in Education’s Blueprint for Maryland’s Future, a multi-year initiative dedicated to developing and recommending considerable educational policy reforms in Maryland. The reforms span over 10 years and are estimated to cost the state an additional \$2.6 billion in the fiscal year 2030, according to the General Assembly. So, it was no surprise when the legislative session opened with a plethora of tax proposals, seeking to increase state revenue to fund the Kirwan Commission’s plan, with a tax on digital advertising to serve as the chief revenue generator for the multi-year educational reform plan.

On March 17, 2020, the General Assembly announced it would end its session on March 18, 2020—due to COVID-19—and reconvene in May. Following the announcement, legislatures hastened to pass laws, with many focused on funding the Kirwan Commission’s recommendations. These were the circumstances under which the nation’s first tax on digital advertising was passed.

³ Pub. L. No. 105-277, Title XI, 112 Stat. 2681 (1998) (enacted as a statutory note to 47 U.S.C. § 151); ITFA § 1101(a). Certain provisions of ITFA were subsequently amended by legislation enacted in 2004 and 2007. See Pub. L. No. 108-435, 118 Stat. 2615 (2004); Pub. L. No. 110-108, 121 Stat. 1024 (2007). All references to the ITFA in this Alert refer to the ITFA in its current form, unless specifically stated otherwise.

⁴ ITFA § 1105(2)(A)(I).

⁵ ITFA § 1105(3).

⁶ *Chamber of Commerce of the United States of America et al. v. Franchot* (Civil No. 21-cv-410 (D. Md., filed Feb. 18, 2021)); *Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Comptroller of the Treasury of Maryland*, Case No. C-02-CV-21-000509 (Md. Cir. Ct Anne Arundel Cty.).

For states attempting to venture into the taxation of an ecosystem as complex, vast, and layered as digital advertising, Maryland's law may well be used as a roadmap of what to avoid when embarking on the endeavor of taxing previously untaxed electronic commerce.

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