

**NetChoice** *Promoting Convenience, Choice, and Commerce on The Net*

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February 10, 2021

Governor Hogan, Attorney General Frosh, Comptroller Franchot, and Members of the General Assembly:

We would like to share a legal analysis of Maryland House Bill 732 prepared by NetChoice counsel (attached). This analysis identifies severe legal flaws in HB 732, which would expose Maryland citizens to expensive and wasteful legal proceedings.

As detailed in the attached, HB 732 includes a facial violation of the federal Internet Tax Freedom Act ("ITFA"), 47 U.S.C. § 151. ITFA explicitly prohibits discriminatory taxes on internet services and transactions. HB 732 is facially discriminatory since it imposes this new tax only on digital advertising, and not on other forms of advertising such as billboards, magazines, newspapers, radio, and television.

In addition, HB 732 would violate the First Amendment of the US Constitution. The legislation would prohibit internet services from displaying a line-item for this new tax when billing advertisers -- most likely to avoid public scrutiny about the new tax. HB 732 is therefore a government limitation on free speech.

It seems clear from the attached memo that an action to enjoin HB 732 is likely to prevail, and that anticipated tax revenues are not likely to be realized. With that, it would be unsound fiscal policy for the state to count on the estimated \$250 million in annual revenue the tax is purported to raise. Relying on projected revenue from this bill in Maryland's budget will leave the state with a deep budget deficit and force cuts in services.

And while it is unlikely that HB 732 would survive legal challenges, the resulting tax burden would fall on many Maryland businesses who are now advertising online to find new customers, at a time when both businesses and customers are struggling under COVID-based restrictions.

Either way, HB 732 is wrong for Maryland.

We therefore encourage Comptroller Franchot and Attorney General Frosh to responsibly remind the General Assembly to avoid relying on any new tax revenue from HB 732, since it is very likely to be enjoined and ultimately overturned by the courts.

Accordingly, we strongly recommend that the General Assembly sustain the Governor's veto.

Sincerely,

Steve DelBianco  
President & CEO  
NetChoice



MEMORANDUM

TO: NetChoice  
FROM: Peter Karanjia  
DATE: February 10, 2021  
RE: Litigation Risk Analysis of Maryland House Bill No. 732

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This memo is a litigation risk analysis of Maryland House Bill 732. It does not address the wisdom of the Bill as a policy matter; it simply focuses on whether the Bill suffers from legal infirmities. We believe that there are serious infirmities under the federal Internet Tax Freedom Act and under the First Amendment and dormant Commerce Clause, and that the Bill would likely be invalidated by a court if enacted into law.

The Bill would impose a new tax—the “Digital Advertising Gross Revenues Tax” (or, for simplicity here, the “Digital Advertising Tax”)—“on annual gross revenues” that a business or person “derived from digital advertising services in the state.” Bill, § 7.5-102(a). “Digital advertising services” are broadly defined to include “advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services.” *Id.*, § 7.5-101(d). A “digital interface” includes, among other things, “a website, part of a website, or application, that a user is able to access.” *Id.*, § 7.5-101(e). Thus, on its face, the Digital Advertising Tax would apply to numerous NetChoice members who derive revenues from online advertising—not only within the State of Maryland, but also outside the State and internationally.<sup>1</sup> In addition, the Bill fails to include any

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<sup>1</sup> The threshold for application of the Digital Advertising Tax is \$1 million in annual gross revenues from digital advertising in the State of Maryland. § 7.5-201(a). Though the Bill includes an “apportionment” formula to determine the assessable revenues base (dividing annual gross revenues attributed to “digital advertising services in the state” by annual gross revenues derived from the same services “in the United



clearly defined requirement of a substantial nexus between the digital advertiser and the State of Maryland (such as advertising specifically targeting Maryland residents).

In our view, the Bill suffers from several serious legal flaws and would likely be invalidated by a court (either on its face or as applied to a digital advertiser subject to the Bill).

First and foremost, the Bill runs afoul of the federal Internet Tax Freedom Act (“ITFA”), which is codified at 47 U.S.C. § 151 (note).<sup>2</sup> As relevant here, ITFA provides that no state may impose “[m]ultiple or discriminatory taxes on electronic commerce.” ITFA, § 1101(a)(2). Electronic commerce is broadly defined to include, among other things, “*any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration.*” *Id.*, § 1105(3) (emphases added). And a state tax is impermissibly discriminatory under the ITFA if the state (a) imposes the tax on electronic commerce but (b) the tax “is not generally imposed ... on transactions involving similar property, goods, services, or information accomplished through other means.” *Id.*, § 1105(2)(A)(i).

By its plain terms, the Bill creates a “Digital Advertising Gross Revenues Tax” that applies *only* to digital advertisers based on revenues they derive “from digital advertising services in the state,” Bill, § 7.5-102(a); the Bill does *not*, however, apply the tax to advertisers who use

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States,” *id.* § 7.5-102(b)), the Bill makes clear that both *national/interstate* and *international* revenues are relevant to the rate of taxation. Specifically, the Bill applies an escalating rate (from 2.5% to 10%) to specified revenue thresholds “for a person with *global* annual gross revenues,” § 7.5-103(1)-(4) (emphasis added).

<sup>2</sup> Initially enacted in 1988 as a moratorium on certain state and local taxes, Congress has renewed ITFA no fewer than eight times and ultimately made the tax moratorium permanent in the Trade Facilitation and Trade Enforcement Act of 2015. See Public Law 114-125, § 922 (“This bill amends the Internet Tax Freedom Act to make permanent the ban on state and local: (1) taxation of Internet access, and (2) multiple or discriminatory taxes on electronic commerce.”).

non-digital forms of advertising, such as print media. This is precisely the type of discrimination that ITFA explicitly prohibits<sup>3</sup>—a prohibition that Congress has repeatedly reaffirmed. The Bill imposes a tax on electronic commerce that “is not generally imposed ... on transactions involving similar property, goods, services, or information accomplished through other means.” ITFA, § 1105(2)(A)(i). Given this obvious discriminatory treatment, it is unsurprising that the State Attorney General acknowledged that the Bill “could raise concerns for a reviewing court,”<sup>4</sup> and Governor Hogan vetoed the Bill in 2020.<sup>5</sup> A court would likely look askance at any decision by the Legislature to forge ahead with the Bill in the face of these serious concerns.

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<sup>3</sup> See, e.g., *Performance Mktg. Ass’n, Inc. v. Hamer*, 998 N.E.2d 54, 59–60 (Sup. Ct. Ill. 2013) (concluding that Illinois statute imposing an online marketing tax was “expressly preempted” by ITFA and its provisions were “therefore void and unenforceable” where the statute singled out out-of-state retailers providing an internet service but did not apply the tax to newspapers and radio stations). If enacted, a subsequently introduced Maryland bill (Senate Bill 787) would further compound this unlawfully discriminatory taxation by *explicitly exempting* from the tax certain preferred advertisers (specifically, any “broadcast entity” or “news media entity”). See Senate Bill 787, § 7.5-101(e)(2).

<sup>4</sup> See Letter dated April 22, 2020 from Attorney General Frosh to Governor Hogan at 1 (“AG Letter”). Affording little reassurance, the AG Letter adds that “it is our view that these provisions are not *clearly* unconstitutional.” *Id.* (emphasis added); see also *id.* at 4 (opining that the tax “would not be *clearly* preempted by federal law”) (emphasis added). A court, however, need not find a “clear” instance of unconstitutionality before invalidating a statute. See, e.g., *Performance Mktg. Ass’n*, 998 N.E.2d at 59–60. Nor does any “presumption” against preemption apply, AG Letter at 4, where a state is attempting to regulate in an area traditionally subject to federal authority. See, e.g., *Ting v. AT&T*, 319 F.3d 1126, 1136 (9th Cir. 2003). Here, given the inherently interstate (and, indeed, global) nature of the internet, digital advertising is inherently interstate activity, and interstate communications have not traditionally been subject to state authority. See, e.g., *Am. Booksellers Found. v. Dean*, 342 F.3d 96, 103-04 (2d Cir. 2003) (“[T]he internet’s boundary-less nature means that internet commerce does not quite ‘occur [] wholly outside [the state’s] borders.’”) (citation omitted).

<sup>5</sup> The AG Letter posits that a reviewing court could “possibl[y]” avoid finding a violation of ITFA if it viewed the relevant “transaction” (one of the prerequisites for the definition of “electronic commerce”) as “the sale of the advertising services from which the revenue subject to taxation is derived instead of the transmission of the advertising itself.” AG Letter at 3. This potential defense of the Bill, however, is unpersuasive. The Bill’s plain text imposes the tax on “on annual gross revenues ... *derived from digital advertising services.*” Bill, § 7.5-102(a) (emphasis added). Accordingly, there is a direct and inextricable link between the tax and “electronic commerce” under ITFA—that is, “*any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration.*” ITFA, § 1105(3) (emphasis added). Indeed, the AG Letter acknowledges that a reviewing court may well instead conclude that “the relevant ‘transaction’ being taxed for purposes of the ITFA is the transmission of digital advertising to a user,” in

Although it would not be necessary for a reviewing court to reach constitutional issues given the Bill’s vulnerabilities on the preemption grounds discussed above, we briefly note that the Bill also raises serious constitutional concerns.

*First*, the Bill raises First Amendment concerns by singling out for a tax a class of speakers (those who engage in digital advertising).<sup>6</sup> As in *Sorrell*, it is doubtful that the Bill would pass muster under “heightened” (or even intermediate) First Amendment scrutiny. Similarly vulnerable would be the provision in the subsequently introduced Senate Bill 787 that prohibits digital advertisers from passing on the new tax to their ad buyers as a separate “fee, surcharge, or line-item.” Senate Bill 787, 7.5-102(c). To the extent that provision would prevent digital advertisers from including line-items on their bills (which are communications with their customers), the provision impinges on the advertisers’ First Amendment rights and cannot withstand that scrutiny.<sup>7</sup>

*Second*, the Bill presents grave concerns under the Constitution’s dormant Commerce Clause. Under that provision, the U.S. Supreme Court has held that a state tax must “(1) apply to

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which case the “transaction” would “occur[] over the internet or through internet access, and *the tax would likely be discriminatory within the meaning of the ITFA.*” *Id.* at 3 (emphasis added). We think that by far the better reading of ITFA and one that a reviewing court would likely adopt.

<sup>6</sup> See, e.g., *Minneapolis Star & Tribune Co. v. Minnesota Comm’r of Rev.*, 460 U.S. 575, 592–93 (1983) (invalidating Minnesota paper and ink tax that singled out a class of speakers); *Arkansas Writers’ Project, Inc. v. Ragland*, 481 U.S. 221 (1987) (Arkansas statute violated First Amendment by taxing general interest magazines, but exempting newspapers and religious, professional, trade, and sports journals); see also *Sorrell v. IMS Health Inc.*, 564 U.S. 552 (2011) (applying heightened First Amendment scrutiny to Vermont statute that imposed content- and speaker-based restrictions on certain marketing practices, and invalidating the statute).

<sup>7</sup> Cf. *Expressions Hair Design v. Schneiderman*, 137 S. Ct. 1144, 1151 (2017) (“In regulating the communication of prices rather than prices themselves,” New York statute regulating surcharges or “swipe fees” for credit cards, “regulate[d] speech” and was subject to First Amendment scrutiny).



an activity with a substantial nexus with the taxing State, (2) [be] fairly apportioned, (3) ... not discriminate against interstate commerce, and (4) [be] fairly related to the services the State provides.” *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2085 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). Yet the Bill contains no limitation requiring a clear “substantial nexus” with Maryland, instead explicitly encompasses “global annual gross revenues,”<sup>8</sup> and relies on a vague apportionment formula<sup>9</sup> that provides no assurance of avoiding impermissible double-taxation and discrimination against interstate commerce. In this regard, it is quite telling that the AG Letter suggests that anticipated regulations may be needed to try to cure these concerns.<sup>10</sup>

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In sum, the Bill suffers from serious legal flaws and would be highly vulnerable to a challenge in court.

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<sup>8</sup> Bill, § 7.5-103(1)-(4).

<sup>9</sup> See *id.*, § 7.5-102(b); see also note 1, *supra*.

<sup>10</sup> See, e.g., AG Letter at 5 (“Of course, because the bill requires the Comptroller to issue regulations to determine whether revenues are derived from Maryland, the Comptroller will have to ensure that the eventual regulations meet the internal consistency test.”).