

# **New York's Proposed Digital Advertising Tax**

**by Joseph N. Endres and Joseph F. Tantillo**

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In this installment of The Endres Assessment, Endres and Tantillo discuss new legislation in New York that would increase the annual tax liability for many businesses operating in the state, a result that a Maryland case aptly represents.

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On March 23 a bill was introduced in the New York State Assembly that would establish a tax on annual gross revenue derived from digital ads in New York state. If passed, A. 5842 and S. 5551 would subject digital advertisers to a 7 percent tax beginning in 2024. This new tax would represent a significant increase in the annual tax liability for many businesses operating in New York; however, the tax would likely first have to survive serious scrutiny by the courts, something we have been watching transpire in Maryland over its new digital ad tax.

The legislation itself amends the tax law to add new article 15, Tax on Digital Ads.

According to the memorandum in support of the bill, its general purpose is to establish a tax on digital ads for persons with global annual gross revenues of \$100 million or more.<sup>1</sup> Section 330 of the new article lists the findings and intent of the legislature. The findings note that “many goods and services that have been traditionally subject to state and local sales use taxes have avoided taxation in the digital era.”<sup>2</sup> It continues:

Many digital transactions are harder to bring into the sales tax base because instead of paying a monetary fee, customers sometimes barter their personal information for access to digital platforms. This personal information is in turn sold for use in targeted advertisements on digital platforms.

The text of the bill then notes that “leading tax economists” suggest taxing receipts from digital advertising as a “proxy for the value of the barter.”<sup>3</sup> In short, the legislature has decided that it would be equitable to tax these services, which have traditionally escaped taxation, in order to account for the transaction we all unwittingly enter into anytime we click the “Accept” button on a “Terms of Service” page that authorizes the use of our personal data.

The new section 332 of article 15 would impose a tax on the annual gross revenues derived from digital advertising services in the state.<sup>4</sup> The term “digital advertising services” is defined to include advertisement services on a digital interface, including advertisements in the

<sup>1</sup> See A05842 Memorandum in Support of Legislation (N.Y. Assembly 2023).

<sup>2</sup> N.Y. A. 5842, section 330(1).

<sup>3</sup> N.Y. A. 5842, section 330(2).

<sup>4</sup> N.Y. A. 5842, section 332, subdivision 1 (Mar. 23, 2023).

form of banner advertising,<sup>5</sup> search engine advertising, interstitial advertising,<sup>6</sup> and other comparable advertising services that use personal information about the people to whom the ads are being served.<sup>7</sup> A “digital interface” is defined as any type of software, including a website, part of a website, or application, that a user is able to access.<sup>8</sup> A “user” means an individual or any other person<sup>9</sup> who accesses a digital interface with a device.<sup>10</sup>

One of the biggest unresolved issues in this area is figuring out a way to properly apportion the revenue. The draft legislation indicates that the tax will be imposed on the receipts apportioned to New York state using a “New York receipts over total receipts” method.<sup>11</sup> But the devil is always in the details. What exactly is a New York receipt? The bill does not answer this question. Instead, the bill authorizes the commissioner of taxation to adopt regulations to determine the amount of revenue derived from each state in which digital ad services are provided.<sup>12</sup> On its face, the legislation provides a comprehensive and broad definition of digital advertising services, which is likely to encompass the activities of most digital advertising companies, but it does not clarify exactly how the revenue will be apportioned. So there are still significant questions about how this tax will function.

The bill does clarify that only persons expected to derive more than \$1 million of revenue from digital advertising services in New York state need to file a return and pay the tax. In other words, the bill creates a \$1 million

threshold requirement for digital advertising companies to be subject to the tax, meaning the bill is not targeting smaller start-ups; rather, this tax exclusively targets well-established, large players.<sup>13</sup> The bill also amends the tax law, adding a new section 1816 that makes it a criminal misdemeanor to willfully violate the new ad tax law, imposing a hefty penalty for those that would look to skirt their potential new tax obligations.

Though the bill is comprehensive in some ways, and would certainly achieve the legislature’s goal of raising revenue from “companies with massive global revenue” if passed, it is likely to face stiff opposition given the recent litigation over digital ad taxes in Maryland. Maryland Circuit Court Judge Alison L. Asti recently found Maryland’s Digital Advertising Gross Revenue Tax Act, enacted in 2021 over Republican Gov. Larry Hogan’s veto, to be in violation of the federal Internet Tax Freedom Act’s prohibition on discriminatory taxes on online services, the Constitution’s prohibition on interference with interstate commerce, the 14th Amendment (because the legislation discriminates against certain online companies by selectively taxing them while not taxing others), and the First Amendment because the legislation is not content-neutral because sites like Facebook and Google would be taxed under the law, but online news sites would not be taxed.<sup>14</sup>

In 1998 Congress passed the ITFA to prohibit state and local governments from imposing “multiple or discriminatory taxes on electronic commerce.”<sup>15</sup> Under that law, a discriminatory tax is one that is imposed on electronic commerce that is not generally imposed on transactions involving similar services accomplished through other means. For New York purposes, this is significant, as revenue

<sup>5</sup> A web banner or banner ad is a form of advertising on the World Wide Web delivered by an ad server. This form of online advertising entails embedding an advertisement into a webpage.

<sup>6</sup> Interstitial ads are full-screen ads that cover the interface of their host app. They’re typically displayed at natural transition points in the flow of an app, such as between activities or during the pause between levels in a game.

<sup>7</sup> N.Y. A. 5842, section 331, subdivision 3.

<sup>8</sup> N.Y. A. 5842, section 331, subdivision 4.

<sup>9</sup> N.Y. A. 5842, section 331, subdivision 5(a) defines person to include the following: any natural individual, receiver, trustee, guardian, personal representative, fiduciary, or representative of any kind and any partnership, firm, association, corporation, or other entity.

<sup>10</sup> N.Y. A. 5842, section 331, subdivision 1.

<sup>11</sup> N.Y. A. 5842, section 332, subdivision 2, 3(a).

<sup>12</sup> N.Y. A. 5842, section 332, subdivision 3(b).

<sup>13</sup> See N.Y. A. 5842, section 333, subdivision 1.

<sup>14</sup> *Comptroller of Maryland v. Comcast of California, Maryland, Pennsylvania, Virginia, West Virginia LLC*, C-02-CV-21-000509 (Md. Cir. Ct. Anne Arundel Cnty. 2022).

<sup>15</sup> P.L. No. 105-277, Title XI, 112 Stat. 2681 (1998) (enacted as a statutory note to 47 U.S.C. section 151); ITFA section 1101(a). Certain provisions of ITFA were later amended by legislation enacted in 2004 and 2007. See P.L. No. 108-435, 118 Stat. 2615 (2004); P.L. No. 110-108, 121 Stat. 1024 (2007).

generated from the sale of advertising services is not generally subject to sales tax.<sup>16</sup>

Maryland's attorney general appealed the circuit court ruling to the Maryland Supreme Court in an attempt to overrule Asti's decision. The Council On State Taxation urged the court in an amicus brief to throw out the tax, saying it discriminates against interstate commerce in violation of the dormant commerce clause by deliberately discriminating against out-of-state corporations.<sup>17</sup> Ultimately, the Maryland Supreme Court ruled that Comcast and Verizon failed to exhaust their administrative remedies before challenging the digital advertising tax in circuit court. In a May 9 per curiam order signed by Chief Justice Matthew J. Fader, the court concluded that the circuit court did not have jurisdiction to hear the constitutional challenge to the tax. The case was remanded to the circuit court with directions to dismiss it.

Opponents of the digital ad tax were hoping that the decision by the Maryland Supreme Court would be rendered on the merits. But for now, they will have to wait for clarity on the constitutional and federal law questions. This decision could affect not only New York's digital ad tax bill but also other states that are considering taxing revenue from digital advertising services. Since the case was not resolved on the merits and the validity of a digital ad tax remains unsettled, other state legislatures may be cautious of enacting similar digital ad taxes. Certainly, such taxes can expect to face a dormant commerce clause argument, an ITFA argument, and First and 14th amendment arguments, for starters.

This is not the first time that the New York State Assembly has attempted to introduce legislation that would create a tax on digital advertising. The legislature introduced similar bills in both the 2019-2020 and 2021-2022 sessions,

and both of those bills never made it out of committee, which is where the current digital ad tax bill resides.<sup>18</sup> Though this iteration of the bill may face the same fate as its predecessors, it is nonetheless an important piece of legislation to keep an eye on. The potential revenue-generating power of a digital ad tax would likely be significant (though, again, we're not exactly sure just how significant because we don't know how revenue would be apportioned). And even in the event that this bill fails, it would not be surprising to see another version of the legislation introduced in the next session. Legislation is often proposed in multiple sessions before ultimately gaining the requisite political momentum to pass into law. We saw this as recently as this past budget cycle in New York when the legislature finally allowed the Department of Taxation and Finance to appeal certain Tax Appeals Tribunal decisions.<sup>19</sup> This had been on the tax department's wish list for many years, and, while the provisions of the law are somewhat circumscribed, it finally passed. We'll probably have more to say on this in a future article.

Ultimately, the legislature's willingness to pass a digital advertising tax will likely be influenced in some manner by *Comcast*. Some New York legislators may be hesitant to pass any legislation that another state's court found to be in violation of the Constitution and existing federal law. Others will not be deterred. Advertising companies that offer digital advertising services in New York will be watching A. 5842 closely. The tax implications of the legislation will likely be consequential for large advertising companies, and, if passed, the tax could be effective as soon as 2024. But at this point, only one thing is certain in this area — much more litigation is on the way. Stay tuned. ■

<sup>16</sup> Moreover, unlike several other states, New York state does not subject the sale of digital products to sales tax. Indeed, during this past budget season, the Assembly advanced a bill that would have imposed sales tax on streaming entertainment and digital products, including popular streaming services, as well as certain apps, games, music, podcasts, and audiobooks (A.3009-B, Part EE). Ultimately, this proposal did not make it into the final budget that was enacted.

<sup>17</sup> Brief for Comcast of California, Maryland, Pennsylvania, Virginia, West Virginia LLC as Amicus Curiae Supporting Respondents, *Comcast of California*, C-02-CV-21-000509.

<sup>18</sup> See N.Y. S. 8056 (2020) and N.Y. S. 1124 (2021).

<sup>19</sup> 2023 N.Y. Laws Ch. 59; the "Budget," Part V.