The Potential Impact on Business to implement the Kirwan Commission Report

The Kirwan Commission on Innovation and Excellence is a multi-year initiative to research and develop major funding and policy reforms to improve the quality of Maryland's public education system. However, the promised investment carries a huge price tag - $40 billion over the next 10 years (FY2030); equivalent to nearly $4 billion in annual mandated spending. State taxpayers will pick up an estimated $2.8 billion (70%) of the costs. The remaining balance will fall on the locals - Baltimore City and the counties (all 23) are responsible $1.2 billion (30%). But both Senate and House Leadership have publicly assured Marylanders that they will not incur new taxes or tax increases to fund this initiative…for now.

So, the $40 billion question that everyone is constantly asking is, "*how are lawmakers going to find the money to pay for it*?" ***Leadership and others have offered some creative, yet questionable methods that could be detrimental to businesses in various industries, including those in printing and advertising.***

Senate Bill 2, entitled, *Digital Advertising Gross Revenues - Taxation* was introduced on the first day of the 2020 session. At its core, the bill imposes a tax on the gross revenues of specified digital advertising. The digital advertising gross revenues tax is imposed at the following rates:

- 2.5% of the assessable base for a person with global annual gross revenues of $100.0 million through $1.0 billion;
- 5% of the assessable base for a person with global annual gross revenues of $1.0 billion through $5.0 billion;
- 7.5% of the assessable base for a person with global annual gross revenues of $5.0 billion through $15.0 billion; and
- 10% of the assessable base for a person with global annual gross revenues exceeding $15.0 billion.

According the Department of Legislative Services (DLS) fiscal note, each person that has annual gross revenues derived from digital advertising services in the State of at least $1.0 million in a calendar year must file a complete return and a declaration of estimated tax with the Comptroller on or before April 15 the next year.

In its current form, the bill has significant legal flaws and is receiving pressure from the business communities. For one, the legislation violates the *federal Permanent Internet Tax Freedom Act (PITFA)*, signed into law by President Barack Obama in 2016. The law prohibits states and localities from assessing taxes on internet access and "discriminatory taxes on electronic commerce." While both digital and traditional physical advertising activities would be subject to Maryland's 8.25% corporate income tax, only digital advertising would be additionally subjected to a gross receipts tax as high as 10%.

The legislation also suffers from constitutional flaws because the tax would be assessed on annual global revenues. As a result, larger global advertising providers would face a higher tax burden than Maryland-only providers. This raises questions about whether the law would lose in a court challenge if its alleging that it violates the *U.S. Constitution's Commerce Clause*. It may also face First Amendment violations based on case law in the highest court in Maryland and in the Nation. In *Grosjean v. American Press Co. and Minneapolis Star Tribune Co. v. Commissioner*, The Court ruled that industry-specific taxes violate the First Amendment's speech protections. In a similar case, the Maryland Court of Appeals ruled that advertising taxes were unconstitutional violations of the First Amendment. Taxing digital advertising, a key revenue stream for media companies, would raise similar challenges.

Lawmakers may be precariously doubling down on forcing the bill's passage and facing legal challenges in the courts. As a side note, PGAMA fought and was successful in gaining tax exemption for print advertising and a concern is that once the legislature goes after "advertising", they may do a deeper dive and revisit our exemption

This tax is just one of the examples being proposed to funding Kirwan, Opportunity Zones may be in jeopardy as well. Created under the 2017 Tax Cuts and Jobs Act, The Opportunity Zone program is a nationwide initiative administered by the U.S. Treasury that provides federal tax incentives for investment in distressed communities over the next 10 years.

Since the 2020 Legislative Session began, lawmakers have introduced several pieces of legislation that would detrimentally impact those businesses and industries in these targeted areas. Below is a brief description of these bills

- **SB122/HB45: Economic Development - Opportunity Zone Incentives - Alteration of the More Jobs for Marylanders and Opportunity Zone Enhancement Programs**

This bill alters the Opportunity Zone Enhancement Program by:

(1) limiting the enhanced tax benefits available under the program to tax years 2019 through 2021;

(2) restricting eligibility for the enhanced benefits under the biotechnology investment incentive and cybersecurity investment incentive tax credit programs to investments made in a company that is established or expands into an opportunity zone on or after March 1, 2018;

(3) requiring businesses in a county with a minimum wage that exceeds the State minimum wage to pay the greater of 120% of the State or county minimum wage; and

(4) altering certain application and reporting requirements.

- **HB223: End Ineffective Business Subsidies Act of 2020**

Also introduced by Delegate Palakovich-Carr, this bill would prohibit the Secretary of Commerce from designating or expanding certain enterprise zones and focus areas on or after June 1, 2020. It would also terminate the One Maryland Economic Development Tax Credit Program on January 1, 2022, while also prohibiting the Department of Commerce from issuing tax credit certificates to certain investors in certain biotechnology companies on or after January 1, 2022.

- **SB263/HB 224: Opportunity Zone Tax Deduction Reform Act of 2020**

The Opportunity Zones Program was designed to incentivize private investment in certain communities. The program offers three federal tax incentives related to capital gains: (1) a temporary tax deferral for capital gains reinvested in an Opportunity Fund; (2) a step up in basis for capital gains reinvested in an Opportunity Fund, which excludes up to 15% of the original capital gain from taxation; and (3) a permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund, if the investment is held for at least 10 years. Investors and investments must also meet numerous other requirements.

Delegate Palakovich-Carr has introduced legislation that would require a person to add back to Maryland adjusted gross income or Maryland modified income the amount of capital gains deferred or excluded under the federal Qualified Opportunity Zones Program.

HB565: Income Tax - Business and Economic Development Tax Credits – Termination

Of all the proposed legislation introduced, HB565, by far, carries the most expansive detrimental impacts to Maryland businesses. If passed, the bill would prohibit the Secretary of Commerce from designating or expanding certain enterprise zones or renewing certain RISE zones on or after June 1, 2020. It would also call for the termination on or after January 1, 2023, of the One Maryland Economic Development tax credit, the Opportunity Zone Enhancement Program, and tax credits for certain biotechnology investment, certain cybersecurity purchases, certain film production activities, and certain small businesses that provide certain employer benefits.

As the Maryland General Assembly considers sources of revenue to fund Kirwan, PGAMA will remain vigilant in monitoring the situation in Annapolis and work to protect the business community from carrying an unfair financial burden.