

TaxNewsFlash

United States



No. 2021-106
March 10, 2021

Maryland: Guidance on digital products and streaming tax; SaaS determined to be taxable

Maryland's Office of the Comptroller issued guidance on digital products and streaming tax and announced that software as a service (SaaS) is taxable.

Much attention has been paid to Maryland's newly enacted tax on digital advertising services. Far less attention has been paid to recently enacted House Bill 932 that expands Maryland's sales and use tax to digital products, digital codes, and streaming services. The Maryland Comptroller's Office recently released [Business Tax Tip #29](#) [PDF 302 KB] *Sales of Digital Products and Digital Code*, which confirms that sales and use tax is imposed on these products and services effective March 14, 2021.

KPMG observation

Significantly—and perhaps most surprisingly—the guidance provides that effective March 14, 2021, sales and use tax will be imposed on receipts from electronically delivered software and remotely accessed software or SaaS, as well as access to online content, as taxable digital products under the new law.

Background

Prior to the enactment of House Bill 932, digital products were not subject to Maryland sales and use tax, and the sale of canned software was taxable only if delivered in tangible form.

On February 12, 2021, the Maryland Senate voted to join the House of Delegates in overriding the governor's veto of House Bill 932. This legislation—the "21st Century Economy Sales Tax Act"—had been passed by lawmakers back in March 2020, but was subsequently vetoed by the governor.

Under Maryland law, tax is imposed on "retail sales." House Bill 932 has redefined the term "retail sale" to include the sale of certain digital products. A "digital product" is defined as "a product that is obtained electronically by the buyer or delivered by means other than tangible storage media through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities."

In addition to taxing digital products, House Bill 932 has expanded the sales and use tax to sales to end-users of subscriptions to, streaming of, access to or the purchase of a digital code for receiving or accessing digital products. The retail sale of a digital code or digital product is presumed to be sourced to the state in which the customer's tax address is located.

Types of digital products, including SaaS, subject to sales tax

House Bill 932 provides various examples of digital products, including but not limited to: movies, videos, e-books, ring tones, audio greeting cards, video or electronic games, online newspapers, magazines and chat-room discussions, and prerecorded or live music or performances. Software was not an enumerated example in the law.

The Comptroller's guidance provides an additional, non-exhaustive list of examples that are considered to be a taxable digital product, including items such as: online classes or instruction, access to online games, customer lists, medical records, design files, models and templates, photographs, and graphics and artwork. This list also includes a sale, subscription or license to access content online and a sale, subscription or license to use a software application.

Under a section addressing "Software," the Comptroller's guidance indicates that the sale of canned or commercial off-the-shelf software is a digital product subject to the Maryland sales and use tax if obtained electronically by the buyer. The sale of software as a service (SaaS) is also, per the guidance, subject to Maryland sales and use tax as a digital product.

KPMG observation

This characterization of SaaS as a digital product will likely catch many SaaS and software providers unaware. In most states, the definition of "digital products" does not include software, which is taxed separately under state law. Likewise, capturing "access to online content" (presumably including access to various databases and research products) as a taxable digital product may catch providers off-guard because most states taxing such items do so as either an information service or a software application.

Guidance for specific types of businesses

The Comptroller's guidance provides additional information as to how the new law affects certain types of businesses. For example, advertising agencies will be selling digital products when the transaction with the client is for the production and electronic delivery of specific property, including: (1) property that the client uses in its business such as signage, letterhead stationery, business cards, annual reports, or audio or video tapes; and (2) property used by the client to convey its commercial message such as brochures, flyers, posters, displays, or finished artwork.

The guidance—that may be viewed as important, given the current COVID-19 environment—addresses various charges for electronically delivered educational services, including lectures, courses, continuing education, seminars or conferences. Charges for viewing or attending courses, continuing education classes, seminars, conferences, and lectures provided electronically are subject to Maryland sales and use tax even if sold by a non-profit or tax-exempt organization such as a college or graduate school.

The guidance also addresses the treatment of entertainment companies and notes that cable television providers are subject to a franchise fee for monthly cable charges, but any movies rented through the cable television provider would be considered digital products subject to sales and use tax. Although monthly charges for satellite television services are not subject to sales and use tax, monthly satellite radio subscriptions will be.

Other measures

The guidance addresses various other aspects of the revised law.

For example, the guidance confirms that the use or transfer of a digital product is not subject to sales and use tax if provided by the transferor and obtained by the end-user free of charge. Sales tax applies only on the sale of a digital product to an end-user, and the guidance explains when certain exemptions or exclusions, such as resale exclusions, may apply. However, the exemption that applies to sales of tangible personal property or taxable services acquired by a buyer who pays sales tax to another state before entering Maryland does not apply to sales of digital products. Therefore, a buyer who pays tax on a digital product to another state before entering Maryland must also pay use tax for a use in Maryland of a digital product.

KPMG observation

Because SaaS and electronically delivered software are considered taxable digital products, companies purchasing subscriptions to software for use across multiple locations (both inbound and outbound) need to consider whether they may purchase such software using a direct pay permit or multiple points of use (MPU) certificate.

With respect to marketplace facilitators, the guidance notes that the definition of a marketplace facilitator does not include entities that list or advertise digital products on a marketplace. Rather, the definition includes marketplaces that list or advertise tangible personal property for sale. As such, a marketplace facilitator is required to collect sales tax on the sales of digital products on behalf of the marketplace seller only if the marketplace facilitator lists or advertises tangible personal property, as well as digital products. In other words, if the marketplace facilitator only lists or advertises digital products over a marketplace, it is not required to collect sales and use tax on such facilitated sales, though it may do so voluntarily.

Finally, the guidance provides additional information on the sourcing rules for sales of digital products and sets forth a hierarchy for determining a customer's address, which is where sales of digital products are presumed to be made.

Effective date

Under the Maryland Constitution, vetoed legislation becomes effective the later of the effective date in the bill, or 30 days after the veto is overridden. House Bill 932 was originally effective July 1, 2020, so the guidance confirms that sales and use tax is imposed on digital products as of March 14, 2021 (30 days after the veto override).

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