

# Business Tax Tip #29

## Sales of Digital Products and Digital Codes

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## Introduction

Effective March 14, 2021, the Maryland sales and use tax applies to the sale or use of a digital product or a digital code. The statutory references contained in this publication are not effective until March 14, 2021. At that date, the sales and use tax rate on a sale of a digital product or a digital code is 6%.

**Business Tax Tip #29 Sales of Digital Products and Digital Codes** was originally published on March 9, 2021. This tax tip has been revised in response to the passage of Senate Bill 787 during the 2021 legislative session and republished on June 3, 2021. This tax tip was updated on July 14, 2021 to add the following subsections: Notification to Vendor; and Digital Codes and Digital Products Used in Multiple States. This tax tip has been revised on July 1, 2022, in response to the passage of House Bill 791 and Senate Bill 723 by the Maryland General Assembly in the 2022 legislative session. The bills were enacted under Article II, Section 17(c) of the Maryland Constitution as Chapters 534 and 535, respectively. The bills altered the definition of "digital product" to exclude certain products where the purchaser has a certain property interest and certain types of computer software.<sup>1</sup>

This tax tip has also been updated to include revisions and additional examples on the following topics:

- advertising;
- agricultural exemption;
- cloud storage services and data transfer fees;
- production activity
- sale of digital advertising space;
- search engine Optimization (“SEO”) services;
- video conferencing software platforms; and
- website design and development; and
- web hosting services.

Business Tax Tip #29 contains a non-exhaustive list of digital codes and digital products the sale of which is subject to the sales and use tax if obtained or delivered by electronic means. If you have questions on Business Tax Tip #29, please contact the Comptroller’s office at

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<sup>1</sup> The legislative history of House Bill 791 and Senate Bill 723 indicates that the exclusions from the definition of digital products reflects the legislative intent of HB 923 as enacted on March 14, 2021. See [https://mgaleg.maryland.gov/mgawebsite/Committees/Media/false?cmte=w%26m&ys=2022RS&clip=WAM\\_2\\_23\\_2022\\_meeting\\_1&url=https%3A%2F%2Fmgahouse.maryland.gov%2Fmga%2Fplay%2Febc8c089-db7e-4746-9757-5b7130d377b5%2F%3Fcatalog%2F03e481c7-8a42-4438-a7da-93ff74bdaa4c%26playfrom%3D7916530](https://mgaleg.maryland.gov/mgawebsite/Committees/Media/false?cmte=w%26m&ys=2022RS&clip=WAM_2_23_2022_meeting_1&url=https%3A%2F%2Fmgahouse.maryland.gov%2Fmga%2Fplay%2Febc8c089-db7e-4746-9757-5b7130d377b5%2F%3Fcatalog%2F03e481c7-8a42-4438-a7da-93ff74bdaa4c%26playfrom%3D7916530)

[sut@marylandtaxes.gov](mailto:sut@marylandtaxes.gov). Business Tax Tip #29 will be periodically updated by the Comptroller's office to provide guidance to taxpayers.

## Retail Sale and Use of a Digital Product or a Digital Code

### Retail Sale

A tax is imposed on a retail sale in Maryland.<sup>2</sup> The definition of a retail sale means:

- tangible personal property;
- a taxable service;
- a digital code; or
- a digital product.<sup>3</sup>

The sales and use tax applies to a sale of a digital code or digital product obtained or delivered electronically by an end user<sup>4</sup> which includes subscriptions, access, receipt and streaming of a digital code or digital product.<sup>5</sup> The sales and use tax applies regardless of whether the buyer has rights of permanent use, rights of less than permanent use or rights of use conditioned on continued payment by the subscriber or buyer.<sup>6</sup>

### Use

A tax is imposed on a use in Maryland of tangible personal property, a digital code, a digital product, or a taxable service.<sup>7</sup> Use means an exercise of a right or power to use, consume, possess, or store that is acquired by a sale for use of tangible personal property, a taxable service, a digital code or a digital product.<sup>8</sup> A use does not include:

- resell the digital product in the form that the buyer receives or is to receive the digital product;<sup>9</sup>
- use or incorporate the digital product in a production activity as a material or part of other tangible personal property or another digital product to be produced for sale;<sup>10</sup>
- an exercise of a right or power over a digital code to receive or access a digital product;<sup>11</sup>

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<sup>2</sup> Tax-General Article § 11-102(a)(2).

<sup>3</sup> Tax-General Article § 11-101(h)(1).

<sup>4</sup> An "end user" means any person who receives or accesses a digital code or digital product for use. An end user does not include any person who receives a digital code or digital product for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution, or exhibition of the digital product.

<sup>5</sup> Tax-General Article § 11-101(h)(2)(v).

<sup>6</sup> Tax-General Article § 11-101(h)(2)(iii)-(iv).

<sup>7</sup> Tax-General Article § 11-102(a)(2).

<sup>8</sup> Tax-General Article § 11-101(n)(1).

<sup>9</sup> Tax-General Article § 11-101(n)(3)(ii).

<sup>10</sup> Tax-General Article § 11-101(n)(3)(iii).

<sup>11</sup> Tax-General Article § 11-101(n)(3)(iv).

- an exercise of a right or power over a digital product acquired by a sale for use if the buyer is not an end user;<sup>12</sup> or
- the use or transfer of a digital product or digital code by the transferor and obtained by the end user free of charge.<sup>13</sup>

## Definition of a Digital Product or a Digital Code

### Digital Product

A digital product means a product that is obtained electronically by the buyer or delivered by means other than tangible storage media using technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.<sup>14</sup>

Maryland law states that a digital product includes the following:

- A work that results from the fixation of a series of sounds that are transferred electronically, including prerecorded or live music or performances, readings of books or other written materials, and speeches;
- Audio greeting cards sent by e-mail;
- A digitized sound file such as a ring tone, that is downloaded onto a device and may be used to alert the user of the device with respect to a communication;
- A series of related images that, when shown in succession, impart an impression of motion, together with any accompanying sounds that are transferred electronically, including motion pictures, musical videos, news and entertainment programs, live events, video greeting cards sent by e-mail, and video or electronic games;
- A book, generally known as an “e-book”, that is transferred electronically; and
- A newspaper, magazine, periodical, chat room discussion, weblog, or any other similar product that is transferred electronically.<sup>15</sup>

Maryland law states that a digital product does not include the following:

- Prerecorded or live instruction by a public, private, or parochial elementary or secondary school or a parochial elementary or secondary school or a public or private institution of higher education;
- Instruction in a skill or profession in a buyer’s current or prospective business, occupation, or trade if the instruction:
  - Is not prerecorded; and
  - Features an interactive element between the buyer and the instructor or other buyers contemporaneous with the instruction;

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<sup>12</sup> Tax-General Article § 11-101(n)(3)(v).

<sup>13</sup> Tax-General Article § 11-101(n)(3)(VI).

<sup>14</sup> Tax-General Article § 11-101(c-4)(1).

<sup>15</sup> Tax-General Article § 11-101(c-4)(2).

- A seminar, discussion, or similar event hosted by a nonprofit organization or business association, if the seminar, discussion, or event:
  - Is not prerecorded; and
  - Features an interactive element between the buyer and host or other buyers contemporaneous with the seminar, discussion, or event; and
- A professional service obtained electronically or delivered through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities;
- A product having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities where the purchaser holds a copyright or other intellectual property interest in the product, in whole or in part, if the purchaser uses the product solely for commercial purposes, including advertising or other marketing activities; or
- Computer software or software as a service purchased or licenses solely for commercial purposes in an enterprise computer system, including operating program or application software for the exclusive use of the enterprise software system, that is housed or maintained by the purchaser or on a cloud server, whether hosted by the purchaser, the software vendor, or a third party.<sup>16</sup>

## Digital Code

Digital code is defined under Maryland law as a number, symbol, alphanumeric sequence, barcode, or similar code that:

- may be obtained by any means, including;
  1. in a tangible form, such as a card; or
  2. through e-mail; and
- provides a buyer with a right to obtain one or more digital products.<sup>17</sup>

Digital code can be obtained by any means including:

- Electronically through computer-mediated communications such as email, text, or messaging; or
- tangible form such as a card, imprint on a product or other storage product.

A “digital code” does *not* include a gift certificate or gift card with a monetary value that may be redeemable for an item other than a digital product.<sup>18</sup>

*Example 1* A retail store sells a variety of gift cards that can be used to purchase goods, services and digital products from other vendors at its store location. A customer selects a gift card in a dollar denomination of \$50 and purchases the gift card at the retail store location. The gift card contains a unique code that is only activated upon purchase. The gift card can only be used to

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<sup>16</sup> Tax-General Article § 11-101(c-4)(3).

<sup>17</sup> Tax-General Article § 11-101(c-3)(1).

<sup>18</sup> Tax-General Article § 11-101(c-3)(2).

purchase and download prerecorded musical songs from another vendor’s website. The gift card cannot be used to purchase goods or services. The sale of the gift card at the retail store is subject to the sales and use tax because it is a sale of a digital code that only entitles the customer to purchase digital products. The sale of prerecorded musical songs using the digital code is not subject to the sales and use tax.

*Example 2* Same facts as above in *Example 1* except that a customer selects a gift card that can be used to purchase goods and download video games at another vendor’s website. The sale of the gift card at the retail store is not subject to the sales and use tax because it is redeemable for an item other than a digital product.

*Example 3* A customer purchases a \$50 gift certificate from a vendor’s website. The gift certificate that entitles the purchaser to limited amount of time to access video games online. Upon purchase, the customer is sent an e-mail with a unique code to use at the vendor’s website to access video games online. The purchase of the gift certificate is a sale of a digital code and is subject to the sales and use tax.

## Subscriptions

The sale of subscription to, access to, streaming of, or the purchase of a digital code for receiving or accessing digital products to an end user is a retail sales and thus subject to the sales and use tax.<sup>19</sup> A subscription means an arrangement with a vendor that grants a buyer the right to obtain digital products from within one or more product categories having the same tax treatment, in a fixed quantity or for a fixed period of time or both.<sup>20</sup>

An annual, periodic, or monthly membership is a subscription subject to sales and use tax. It is not necessary that the product be delivered to the purchaser. As long as the purchaser is permitted access to the product, it will be considered to have been electronically transferred to the purchaser.

## Services Performed Electronically

### Taxable Services

Under Maryland law, only specifically enumerated taxable services are subject to the sales and use tax.<sup>21</sup> House Bill 932 revised the list of taxable services to state “fabrication, printing, or production of tangible personal property or a digital product.” A taxable service is subject to the sales and use tax regardless of how the service is delivered.

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<sup>19</sup> Tax-General Article § 11-101(h)(2)(V).

<sup>20</sup> Tax-General Article § 11-101(j-4).

<sup>21</sup> See Tax-General Article § 11-101(m) for a list of taxable services.

## Non-Taxable and Professional Services

Any service that is not enumerated as a taxable service is not subject to the sales and use tax regardless of how the service is delivered. In addition, a digital product does not include “a professional service obtained electronically or delivered through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.”<sup>22</sup>

The sales and use tax also does not apply to a personal, professional or insurance service that is not a taxable service but involves a sale of a digital code or a digital product as an inconsequential element for which no separate charge is made.<sup>23</sup> Examples of non-taxable services that involve the sale of a digital code or a digital product as an inconsequential element are services rendered by physicians, dentists, lawyers, accountants, and insurance agents.<sup>24</sup>

*Example 1* An attorney is engaged to provide estate planning services for a client in Maryland. A will and related documents are executed by the client. The attorney provides a copy of the will and the related documents to the client. The client also downloads a PDF of the estate planning documents from the tax preparer’s client portal. The invoice reads for “\$900 for will drafting and estate planning services.” Legal service is a non-enumerated, non-taxable service. The PDFs of the estate planning documents are an inconsequential element to the service. The charge for the creation and execution of the estate planning documents are not subject to the sales and use tax.

*Example 2* An attorney or CPA provides tax preparation services to a client located in Maryland. The client downloads a PDF of the tax return from the client portal. The requests additional copies of the tax return. The invoice reads as: “\$500 for preparation of tax return preparation, \$40 charge for software use and \$25 for multiple copies of a 250-page tax return”. As a non-enumerated, non-taxable service, for which the electronically obtained tax return is an inconsequential element to the service there is no sales tax due on the tax preparation service. The sales and use tax does not apply to the separate charge for software use but sales and use tax applies to the separately stated charge for multiple copies of the tax return which is tangible personal property. The answer would be different if there was a single \$565 charge or single line-item on the invoice for “tax preparation and related services.” The entire charge is not subject to the sales and use tax because the tax preparation service is the dominant purpose of the transaction.

*Example 3* An employment placement firm conducts reference checks on an employment applicant and sends a report to the prospective employer on that applicant's references for the reference check service. As this is not one of the enumerated services that is subject to

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<sup>22</sup> Tax-General Article § 11-101(c-4)(3)(IV).

<sup>23</sup> Tax-General Article § 11-219(a); COMAR 03.06.01.01(A).

<sup>24</sup> COMAR 03.06.01.01(A).



Maryland sales and use tax, the charge for the service and delivery of the report in either digital form or tangible form is not subject to tax.

*Example 4* A website allows employers to post employment opportunities online. Job seekers can search, view, and apply to the employment opportunities online. The operator of the website charges the employers a fee to post the employment opportunities online. The placement of employment advertisements online is a non-enumerated, not-taxable service and thus, is not subject to the sales and use tax.

*Example 5* A patient makes an appointment with a doctor to discuss a medical concern. The patient chooses to hold the appointment through a video conference rather than appear in person at the doctor's office. Health care is a non-enumerated, non-taxable service. The doctor's professional service is not subject to the sales and use tax because the service is delivered electronically.<sup>25</sup>

*Example 6* A company offers web hosting services that allow a person or business the ability to house and post a website on the internet. Web hosting is a non-enumerated, non-taxable service. Therefore, the company should not charge the sales tax on web hosting services.

### Bundled Transactions

A bundled transaction is the retail sale of two or more items if the items are not separately stated and sold for one price, including tangible personal property, taxable or non-taxable services, or a digital product. The entire charge for a bundled transaction that involves the sale of a digital product and a non-taxable service or non-taxable tangible personal property is subject to the sales and use tax if the dominant purpose of the sale is to obtain a digital product. The sales and use tax does not apply to a charge for a personal, professional, or insurance service that is not a taxable service but involves a sale of a digital code or digital product as an inconsequential element for which no separate charge is made.<sup>26</sup>

## Taxable Price of a Digital Product or a Digital Code

The sales and use tax is computed on the "taxable price" of a digital product or a Digital Code. In general, the taxable price of a digital product or a digital code is the purchase price. However, taxable price is broadly defined by statute to include, with certain specific exceptions, the total consideration for the transaction, which may be either in the form of money, rights, property, promises or anything else of value, or by exchange or barter.<sup>27</sup> The use or transfer of a digital

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<sup>25</sup> A digital product does not include "a professional service obtained electronically or delivered through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities." Tax-General Article § 11-101(c-4)(3)(IV).

<sup>26</sup> Tax-General Article § 11-219(a).

<sup>27</sup> Tax-General Article § 11-101(l); COMAR 03.06.01.08.

product or a digital code is not subject to sales and use tax if provided by the transferor and obtained by the end user free of charge.

## Advertising Agencies

A contract with an advertising agency may involve components of both non-taxable services and the production of a product that is either a tangible personal property or a digital product.

### *Non-taxable Services*

An advertising agency is providing advertising services that are not subject to Maryland sales and use tax when the transaction with the client is for:

- the preparation and placement of advertising in print, broadcast or digital media;
- public relations;
- setting up press conferences;
- conducting market research;
- creative concept development;<sup>28</sup>
- website design and development; and
- digital advertising including:
  - Banner and Display Advertising
  - Interstitial Advertising
  - Paid Search Advertising
  - Search Engine Optimization (“SEO”)
  - Pay-per-click advertising.<sup>29</sup>

*Example 1* An operator of a website sells digital advertising space on its website. A third-party vendor bids upon and wins the advertising space. The third-party party charges an advertising agency for the advertising space on behalf of the agency’s client. The advertising agency who in turn bills the client for its cost-plus marketing fees. The charge by the website operator, third-party vendor and the advertising agency’s charge is not subject to the sales and use tax.

### *Sale of Products by Advertising Agencies*

A digital product does not include a product having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities where the purchaser holds a copyright or other intellectual property interest in the product, in whole or in part, if the purchaser uses the product solely for commercial purposes, including advertising or marketing activities.<sup>30</sup>

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<sup>28</sup> COMAR 03.06.01.38.

<sup>29</sup> Digital advertising services are not subject to the Maryland sales and use tax. However, digital advertising services are subject to other Maryland taxes.

<sup>30</sup> Tax-General Article §11-101(c-4)(c)(v).

An advertising agency is not performing a non-taxable service when the transaction with the client is for the production and electronic delivery of specific property including the following:

- Signage
- Letterhead or stationary
- Business Cards
- Annual Reports
- Brochures
- Flyers
- Posters
- Displays
- Finished Artwork
- Photographs
- Illustrations
- Graphics
- Videos

Therefore, the sale of these products is subject to the sales and use tax whether delivered in tangible or electronic format. However, if electronically delivered or obtained, a sale of these products by an advertising agency to a client is not subject to Maryland sales and use tax if the client:

- holds a copyright or other intellectual property interest in the product; and
- uses the product for commercial purposes.

*Example 1* An advertising, marketing, and design firm, Design, Inc. is engaged by Company X, a Company with all operations in Maryland, to develop a brand marketing campaign consisting of concepts, story lines, tag lines, commercial scripts, graphic designs, photos, and videos. The advertising campaign will feature Company X's trademarked logo and Company X will have exclusive use of the marketing campaign.

The contract between Design, Inc. and Company X provides that Design, Inc. will charge Company X \$100,000 for the services for creating the concepts of the brand marketing campaign including all draft concepts and if the Company requests the concepts will charge \$20,000 for the production of the final digital graphic images, photos and videos to be used by Company X in television, website, and or social media advertising to customers in Maryland.

Design, Inc. invoices Company X separately for the \$100,000 of services and \$20,000 of final digital products. Design, Inc. is not required to charge Maryland sales tax on the \$100,000 brand marketing concept creation as it is a non-taxable service provided to Company X. Design, Inc. is not required to charge 6% Maryland sales tax on the \$20,000 for the final digital products including graphic images, photos and videos as Company X's use of the digital products will be in television, website and social media advertising to customers in Maryland. The result is the same if Design, Inc. combines the charge for services and digital products into one charge for \$120,000 on its invoices.

*Example 2* Company X contracts with Design, Inc. to design and host its website. Company X's trademarked logo will be featured throughout the website. The charge for designing and hosting the website by the Design X is not subject to the sales and use tax. Company X holds a copyright

or other intellectual property interest in the website and uses the product for commercial purposes. Therefore, the advertising agency should not charge the sales tax for services to design the Company X's website. The advertising agency should pay sales and use tax on the purchase of any clip art, photographs or videos that are incorporated into the website design.

*Example 3* Joe's Logo Shop designs custom digital graphics and logos for customers. The custom logos are generally for use on customer's marketing materials such as t-shirts, drinking cups, pens, etc. Joe's Logo Shop does not retain no right to sell the custom logos to other customers or use the custom logo in any manner.

Upon final approval, Joe Logo Shop transfers the logo via e-mail for a flat fee of \$250 to the customer. If the customer will use the logo for marketing materials and the customer has a copyright or an intellectual property interest in the business name or logo, the Maryland sales and use tax does not apply to the sale. If the customer will use the custom logo for personal use or does not have a copyright or an intellectual property interest in the business name or logo, then the Maryland sales and use applies to the sale.<sup>31</sup>

*Example 4* A law firm engages an advertising company to redevelop their website for \$100,000. In addition to web development, the contract includes advertising strategy and planning, design, digital marketing, rebranding, and videography and photography services. Although the contract calls for videos and photos as part of the website development, the dominant purpose of the contract is for non-taxable service of advertising strategy and planning. Therefore, the contract is not subject to the sales and use tax. If the advertising agency were to charge a separate fee for a finished design, logo or other artwork, the separate charge would be subject to the sales and use tax.

#### *Purchase of Digital Products by Advertising Agencies*

An advertising agency shall pay sales and use tax on purchases of digital products that it uses or consumes in providing advertising services unless the digital product will be incorporated as component or part of a sale of tangible personal property, a taxable service or a digital product. An advertising agency may claim the resale exclusion for purchase of digital products solely for resale to a client in the same form in which it receives the digital product.

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<sup>31</sup> Registration of a trade name with the Maryland State Department of Assessment and Taxation does not confer a copyright or an intellectual property interest such as a trademark or service mark in a business name or logo. See <https://sos.maryland.gov/Pages/Trademarks/TrademarkFAQ.aspx>

## Education

### Charges for Continuing Education Classes, Seminars or Conferences that are Delivered in Person and not Delivered Electronically

A charge for attending a continuing education class, seminar or conference in-person is not subject to sales and use tax. The provider must pay the sales and use tax on the purchase of educational materials that it provides incidentally with the nontaxable educational program.

### Charges for Continuing Education Classes, Seminars or Conferences Delivered Electronically

Under Maryland law, “prerecorded or live music or performances, readings of books or other written materials, and speeches” delivered electronically are a digital product. Therefore, in general, charges for viewing or attending prerecorded or live continuing education classes, seminars or conferences that are delivered electronically are subject to sales and use tax.<sup>32</sup> However, a digital product does not include “instruction in a skill or profession in a buyer’s current or prospective business, occupation, or trade if the instruction is not prerecorded and features an interactive element between the buyer and the instructor or other buyers contemporaneous with the instruction.” Thus, a charge for prerecorded instruction is subject to the sales and use tax while a live instruction is not taxable.

The provider is not required to pay the sales and use tax on the purchase of educational materials that it provides incidentally if the educational program is taxable. The educational materials are resold to the customer.

*Example 1* A for-profit company provides online classes to obtain a certificate in information technology (“IT”). The IT classes presented by an instructor through a video conferencing platform. Attendees can interact with the instructor during class. The company charges for each class separately. The charge is not subject to the sales and use tax because the instruction is live and features a contemporaneous interactive element between the instructor and the buyer.

*Example 2* A for-profit website charges a fee for viewing a prerecorded video on sales skills. There is no live interaction between the instructor and the buyer. The charge is subject to the sales and use tax.

*Example 3* A for-profit website charges a fee for viewing a prerecorded video on leadership skills in business. After viewing the prerecorded video, the buyer can send comments or questions to the instructor. The charge is subject to the sales and use tax. The instruction is prerecorded and the interaction is not contemporaneous with the instruction.

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<sup>32</sup> There is no exemption from sales and use tax under Maryland law for the sale of a digital product on the basis that the product would have been exempt from sales and use tax if it had been delivered in tangible form or by other means.

*Example 4* A for-profit website charges a fee for viewing a prerecorded video on leadership skills in business. During the prerecorded video, the buyer can send comments or questions to the instructor. The charge is subject to the sales and use tax. While the interaction between the instructor and the buyer is contemporaneous with the instruction, the instruction is prerecorded.

*Example 5* A for-profit company provides an instructional course to help law school graduates pass the Maryland Bar Examination. The instructional course features multiple several instructional presentations delivered electronically through a video conferencing platform over an eight-week period. The majority of the instructional presentations are provided by a live instructor and attendees can interact with the instructor. Some of the presentations during the courses are prerecorded material. The company charges a one-time fee to attend the presentations. The charge is not subject to the sales and use tax because the course includes live instruction and an interactive element between the instructor and vendor.

### Charges by Non-Profit Organizations for Continuing Education Classes, Seminars or Conferences Delivered Electronically

A digital product does not include “a seminar, discussion, or similar event hosted by a nonprofit organization or business association, if the seminar, discussion, or event is not prerecorded; and features an interactive element between the buyer and host or other buyers contemporaneous with the seminar, discussion, or event.” A charge for viewing or attending live continuing education classes, seminars or conferences provided electronically is not subject to the sales and use tax if sold by a non-profit organization or business association.

A charge for viewing or attending prerecorded continuing education classes, seminars or conferences provided electronically is subject to sales and use tax even if sold by a non-profit organization or business association. However, the sales and use tax does not apply to a sale of a prerecorded or live seminar by a bona fide church or religious organization, if the sale is made for the general purposes of the church or organization.<sup>33</sup>

*Example 1* A religious organization holds live seminars and speeches to raise funds for its organization. The live seminars and speeches are delivered electronically through a video conferencing platform. The attendees can interact with the instructors either during or at the end of the seminar or speech. The charge for the seminar or speech is not subject to the sales and use tax.

*Example 2* A non-profit professional organization holds live continuing education seminars. The live continuing education seminars are delivered electronically through a video conferencing platform. Attendees can interact with the instructors through a chat function at the end of the

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<sup>33</sup> Tax-General Article 11-204(b)(1).

seminar. The charge is not subject to the sales and use tax because the instruction is live and features a contemporaneous interactive element between the instructor and the buyer.

*Example 3* Same facts as *Example 2*. However, the non-profit professional organization allows the attendee of the live seminar to access a prerecorded version for 30 days. The charge is not subject to the sales and use tax because the charge includes live instruction and features a contemporaneous interactive element between the instructor and the buyer.

*Example 4* A non-profit professional organization holds live continuing education seminars. The live continuing education seminars are electronically videotaped. The non-profit professional organization posts the recorded seminar on its website and allows customers to purchase and view the prerecorded seminar at any time. The charge is subject to the sales and use tax because the entire instruction is prerecorded.

### Charges for Online Courses and Lectures by a School

Digital products do not include “prerecorded or live instruction by a public, private, or parochial elementary or secondary school or a parochial elementary or secondary school or a public or private institution of higher education.” A charge for viewing a course or lecture online by an elementary school, middle school, high school, college or graduate school is not subject to the sales and use tax.

*Example 1* A college charges tuition to attend classes in-person or entirely online through its website. The charge to attend classes online is not subject to the sales and use tax.

*Example 2* A college charges tuition to attend classes in-person. The college also offers separate professional learning courses to enrolled student and non-enrolled students. The charge for the professional learning course is not subject to the sales and use tax. The result is the same whether the professional learning courses are prerecorded or live.

### Charges for the Sale of Textbooks

The sale of a textbook, whether in tangible form or delivered electronically, is subject to the Maryland sales and use tax. The purchase of an access code to view and/or download an electronic book is also taxable as the sale of a digital book. Unless a specific exemption applies, sales tax must be charged whether the sales is made by an educational institution or a commercial vendor.

### Entertainment

The sales and use tax applies to a charge for a digital download or stream of a prerecorded motion picture, music video, news and entertainment program, live event, sporting event, tutorial, etc.

## Pre-recorded Audio and Video Content

A charge to download or access pre-recorded audio and video content is subject to the sales and use tax.

*Example 1* A for profit company operates a website that allows customers to purchase and view prerecorded music concerts. The charge to view the prerecorded music concert is subject to the sales and use tax.

*Example 2* A nonprofit professional organization operates a website that allows customers to purchase and view prerecorded music concerts. The charge to view the prerecorded music concert is subject to the sales and use tax.

*Example 3* A religious organization charges a fee to watch a prerecorded event to raise funds for its organization. The prerecorded concert is delivered electronically through the organization's website. The charge for the concert is not subject to the sales and use tax.<sup>34</sup>

## Streaming Audio and Video Services

A monthly charge for streaming audio and video is subject to sales and use tax. Sales, licenses, and subscriptions of digital products and digital codes to end users are subject to the 6% sales and use tax regardless if that use is limited to a specific time period or for permanent use. For example, a charge of \$9.99 per month that allows a consumer to receive the right to stream and view movies and television shows on an unlimited basis, is subject to the sales and use tax.

## Cable Television

A monthly charge to view cable television is subject to a franchise fee but not subject to the sales and use tax.<sup>35</sup> However, a charge for a movie rental or purchase through a cable television system is subject to the sales and use tax. Pay-per-view television is a taxable service under Maryland law and subject to Maryland sales and use tax.<sup>36</sup>

## Satellite Television and Radio Services

A monthly charge for either satellite radio or satellite television service is not subject to the sales and use tax.<sup>37</sup>

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<sup>34</sup> The sales and use tax does not apply to a sale by a bona fide church or religious organization, if the sale is made for the general purposes of the church or organization. Tax-General Article 11-204(b)(1).

<sup>35</sup> Multichannel video programming service was removed from the list of taxable services in Tax-General Article § 11-101(m). Multichannel video programming service included a cable service, as defined in 47 U.S.C. § 522(6).

<sup>36</sup> Tax-General Article § 11-101(m)(8).

<sup>37</sup> Multichannel video programming service was removed from the list of taxable services in Tax-General Article § 11-101(m). Multichannel video programming service included direct-to-home satellite services, as defined in 47 U.S.C. § 303(V).



## Live Music Performances

A charge to view a live music performance of any type that is accessed electronically is subject to sales and use tax.<sup>38</sup> However, a charge to view a live music performance of any type in-person is not subject to the sales and use tax. A charge to view a live music performance in-person may be subject to Maryland's admissions and amusement tax.<sup>39</sup>

*Example 1* A for profit company operates a website that allows customers to view live music concerts at any time. The charge to view the live music concert is subject to the sales and use tax. The charge for live streams of music concerts.

*Example 2* A non-profit organization holds a live music concert to raise funds for its organization. The live concert is delivered electronically through a video conferencing platform. The attendees cannot interact with the musicians. The charge for the concert is subject to the sales and use tax.

*Example 3* A religious organization holds a live music concert to raise funds for its organization. The live concert is delivered electronically through a video conferencing platform. The attendees cannot interact with the musicians. The charge for the concert is not subject to the sales and use tax.

## Books, Magazines, Newspapers, Periodicals, and other Products

The sale of a book, e-book, magazine, newspaper<sup>40</sup>, periodical, chat room discussion, weblog or any similar product for a charge<sup>41</sup> is subject to sales and use tax whether delivered electronically or in tangible form.<sup>42</sup> The sale of a newspaper that is distributed by the publisher at no charge is not subject to the sales and use tax whether delivered electronically or in tangible form.

*Example 1* A publisher sells a subscription to access a weekly newsletter with articles on tax and accounting issues. Each subscriber receives the same weekly newsletter as all other subscribers. The publisher's website allows the subscriber to search for previously published articles in its weekly subscription. The subscription charge is subject to the sales and use tax.

*Example 2* A legal research company sells a monthly subscription that allows subscribers to research federal and state statutes, regulations and court cases, the subscription fee to research cases is not subject to the sales and use tax because the company offers a non-enumerated,

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<sup>38</sup> Tax-General Article § 11-101(c-4)(2)(1)(i)(1).

<sup>39</sup> For more information about Maryland's admissions and amusement tax on charges on in-person live performances, please see the following [webpage](#).

<sup>40</sup> Art. 81, §§ 326, 375. Provided an exemption from newspapers whether distributed by the publisher for a fee or at no charge. However, Tax-General Article § 11-215 was amended in 1995 Maryland Laws Ch. 151 (S.B. 274) (.S.B. 274) to remove for the exemption for newspapers sold for a fee.

<sup>41</sup> The inclusion of "chat room discussion, weblog or any similar product for a charge" is included within the definition of a digital product by statute and is not administrative interpretation by the Comptroller's office.

<sup>42</sup> Tax-General Article § 11-101(c-4)(2)(v).

non-taxable service. For a separate charge, the legal research company allows subscribers to download PDFs of treatises, textbooks, journals and articles that are outside of the research service subscription. The charge for these separate downloads is subject to the sales and use tax because the physical version is subject to the sales and use tax.

*Example 3* A company operates a website that allows users to post a profile of themselves and interact with other users in real time. There is no charge for the user to sign up, create a profile and interact with other users. However, the company offers a premium subscription plan for a monthly access fee. The premium subscription plan provides the same interactive features as the free service but allows users additional content and features. A chat room discussion, weblog, or any other similar product that is transferred electronically is a digital product and the sale of a subscription for access is subject to the sales and use tax.

## Documents, Information Services, Lists, Reports

The sales and use tax has historically applied to the sale of customer lists, mailing lists,<sup>43</sup> medical records,<sup>44</sup> and standard data reports<sup>45</sup> if transferred to a buyer in a tangible format. However, the sales and use tax does not apply to data and information processing services even if provided to a buyer in a tangible format.<sup>46</sup> Therefore, the sale of data and information processing services delivered or obtained electronically is not subject to the sales and use tax because they were not subject to sales.

The sale of a customer list, mailing list, medical report which is static and not customized to a specific buyer does not constitute data or information processing and is therefore subject to the sales and use tax if delivered or obtained electronically. Similarly, a data report that is available for sale to the public and can access by electronic means is subject to the sales and use tax. The fact that the buyer may independently to choose to receive some or all a vendor's data reports does not rise to a custom report or data and information processing service. A charge to access a website that provide standard reports that can be customized by the customer is not a data or information processing service. To qualify as a data or information processing, the vendor must be contractually obligated to sort and process data into a unique document or report for a particular customer at the customer's request.

*Example 1* A Maryland company Smallco, Inc. has agreed to be purchased by another Maryland Bigco, Inc. Smallco, Inc. will sell of its assets to Bigco, Inc. including its list of customers as of the

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<sup>43</sup> The sale of subscription lists containing names, addresses and other customer information in tangible form is subject to the sales and use tax. See *Disclosure Information Group v. Comptroller of the Treasury*, 72 Md. App 381, 530 A.2d 8 (1987). The sales and use tax does not apply to a sale of computerized mailing lists to the extent used for the purpose of providing addresses to which direct mail advertising literature and mail order catalogues will be distributed outside of Maryland. Tax-General Article § 11-215(d)(1).

<sup>44</sup> The sale of a patient's medical records to the patient or the patient's representative is exempt from the sales and use tax. Tax-General Article § 11-211(a)(4).

<sup>45</sup> *McGraw-Hill, Inc. vs. Comptroller of the Treasury*, 1990 WL 210644 (Md.Tax).

<sup>46</sup> *Quotron Systems, Inc. vs. Comptroller of the Treasury*, 278 Md. 178 (1980).

date of the sale. The customer list will be transferred electronically to Bigco, Inc. The sale of the customer list is a digital product transferred electronically and is subject to the sales and use tax.

*Example 2* A publisher sells reports which contain daily information on construction projects. The publisher collects data and publishes reports on a subscription basis. The daily reports provide information for construction companies to allow them to accurately bid on current and upcoming construction projects. Each subscriber who receives a report receives the same report as all other subscribers. The sale of the subscription is subject to the sales and use tax.

*Example 3* A Maryland financial service company contracts with an investment firm in New York to receive information and advice on which stocks to invest in on behalf of clients. The investment firm provides customized investment reports to each customer including the Maryland financial service company. The charge for customized information services is not subject to the sales and use tax.

*Example 4* A out-of-state company operates a website that connects homeowners with contractors to provide services such as home repair, cleaning services and lawn care services. Homeowners sign up on the website to find certain services in their area. Contractors pay a fee to the out-of-state company to advertise on the website. Homeowners provide their contact and location information and communicate with the website if they are interested in a particular service. A customized list of potential customers or leads are sent to the contractors for a separate charge. The charge to receive a customized list of leads is data or information processing services and is not subject to the sales and use tax.

## Electronic Communications

A digital product includes “a chat room discussion, weblog, or any other similar product that is transferred electronically.” The sales and use tax applies to a charge to access or a subscription to a chat room, discussion, weblog, or any other venue that permits users to communicate electronically in real time.

## Photography and Videography

The sale of a photograph, stock photographs or stock artwork, clip art, portrait and wedding photography, pictures and similar products are digital products if delivered electronically. The services to produce photography, artwork, clip art, portrait and wedding photography, pictures, videos, and similar digital products, when separately charged from the digital product result of such services, are non-taxable services.<sup>47</sup>

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<sup>47</sup> A long-standing regulation, COMAR 03.06.01.16, has historically applied the sales and use tax to charges for photography and video production to create photographs and videos in tangible form even if separately stated by the vendor. A proposed regulation has been published by the Comptroller’s office in response to the enactment of HB 932.

*Example 1* A photography and video company, Photos, Inc. is engaged by Company Y, a Company with all of its operations in Maryland, to take photos and videos of Company Y's products for use on Company Y's website site and social media advertising to sell its products.

The contract between Photos, Inc. and Company Y provides that:

- Photos, Inc. will charge Company Y \$10,000 for the service to take the photos and videos of Company Y's products and provide draft proofs for Company Y's viewing and approval with no obligation to purchase the photos or digital product;
- If Company Y requests to purchase the final digital photos or videos, Photo, Inc. will charge \$2,000 to produce the final digital graphic images, photos, or videos to be utilized by Company Y on its website and social media advertise to customers in Maryland.

Photos, Inc. invoices Company Y separately for the \$10,000 of services and \$2,000 to produce the final digital products. Photos, Inc. is not required to charge Maryland sales tax on the \$10,000 of photo and videos services as they are non-taxable services.

Photos, Inc. is required to charge 6% Maryland sales tax on the \$2,000 for the final digital products including graphic images, photos and videos as Company Y's use of the digital products will be on their website and social media advertising to customers in Maryland.

## Ringtones

The sales and use tax applies to the sale of a digitized sound file such as a ring tone, that is downloaded onto a device and may be used to alert the user of the device with respect to a communication.<sup>48</sup>

## Software

The sale of canned or commercial off-the-shelf ("COTS") software if delivered in tangible form is subject to the sales and use tax.<sup>49</sup> Effective March 14, 2021, the sale of canned or COTS software obtained electronically by the buyer is a digital product and is subject to the Maryland sales and use tax.<sup>50</sup> Thus, the sale of software or software as a service (SaaS) that is delivered or obtained electronically is subject to the sales and use tax unless it is excluded from the definition of digital product or the exemption for customized software applies to the sale.

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<sup>48</sup> Tax-General Article § 11-101(c-4)(2)(ii).

<sup>49</sup> See *Comptroller of the Treasury v. Equitable Trust Company*, 296 Md. 456, 464 A. 2d. (1983).

<sup>50</sup> Software is a product obtained electronically by the buyer or delivered by means other than tangible storage media using technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. [https://mgaleg.maryland.gov/2020RS/fnotes/bil\\_0002/hb0932.pdf](https://mgaleg.maryland.gov/2020RS/fnotes/bil_0002/hb0932.pdf) ("The advent of the digital age has contributed to the erosion of the sales tax base as consumers have transitioned from purchasing tangible goods to digital goods, such as computer software, music, videos, and other electronic files.")

A digital product does not include computer software or software as a service purchased or licenses solely for commercial purposes in an enterprise computer system, including an operating program or application software for the exclusive use of the enterprise software system, that is housed or maintained by the purchaser or on a cloud server, whether hosted by the purchaser, the software vendor, or a third party.<sup>51</sup>

The vendor is not required to obtain and retain an exclusion or exemption certificate from the buyer for the exclusion. However, the vendor and buyer should retain documentation that the sale meets the statutory exclusion.

## Individual vs. Commercial Use of Software

### *Purchases for Individual Use*

The sale of software or SAAS to an individual for non-commercial use is subject to Maryland sales and use tax unless another exemption applies to the sale.

### *Purchases for Commercial Use*

The taxability of the sale of software or SAAS to an individual or entity for commercial use depends on whether the software is used in an enterprise computer system. An enterprise computer system is not defined by statute but includes the following:

- a set of software packages working together as an interconnected network;
- a purchase or license of computer software for simultaneous use on multiple computers that is housed or maintained on an enterprise server, cloud server, or end users' computers; or
- software designed to run a computer system, an operating program, or application software.

If the software is purchased for commercial purposes but cannot be used by multiple users and does not operate with other software or computers, the sale is subject to Maryland sales and use tax.

*Example 1* A hair salon owner purchases and downloads basic accounting software to keep track of sales, create invoices and profit and loss statements. The software is COTS and the sale is subject to the sales and use tax.

*Example 2* A vendor licenses software to an individual or business customer located in Maryland. The vendor licenses separate software packages for accounting, bookkeeping, budgeting, e-mail, payment processing, and financial reporting. The software packages are intended to interact seamlessly with each other and can be operated as intended as soon as the software is accessed

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<sup>51</sup> Tax-General Article § 11-101(c-4)(c)(vi); Although the statutory exclusion is effective July 1, 2022, the legislative history of HB 791 and SB 723 indicates that the software exempted by the bill was never intended to be included in the definition of a digital product as enacted in H.B. 932.

or installed. The software does not require configuration to use. The vendor is not required to charge the Maryland sales tax on the sales of software.

### Items Determined Not to be Digital Products

The sale of the following has been determined by the Comptroller's office to not be digital products such to Maryland sales and use tax whether sold to a taxpayer for personal or business use:

- Cloud Storage Services and Data Transfer Fees;
- Search Engine Optimization ("SEO") Services;
- Video Conferencing Software Platforms;<sup>52</sup> and
- Web Hosting Services.

### Exemption for Customized Software

The sales and use tax does not apply to a sale of custom computer software, regardless of the method transferred or accessed, or a service relating to custom computer software that:

- would otherwise be taxable under this title;
- is to be used by a specific person;
- is created for that person or contains standard or proprietary routines requiring significant creative input to customize, configure, or modify the procedures and programs that are necessary to perform the functions required for the software to operate as intended; and
- do not constitute a program, procedure, or documentation that is mass produced and sold to:
  - the general public; or
  - persons engaged in a trade, profession, or industry, excepted as provided above.<sup>53</sup>

Software that is customized, configured or modified is software that does not operate immediately as required by the buyer (i.e. "out of the box") and includes enterprise software, such as but not limited to the following:

- General Ledger Systems
- Budgeting and Forecasting Systems
- Vendor Management and Payment Systems
- Tax Engine, Provision and Compliance Systems
- Human Resource Management Systems
- Payroll, Compensation, and Benefit Systems

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<sup>52</sup> A taxable service includes a "cellular telephone or other mobile telecommunication service." However, at the time of enactment of Tax-General Article § 11-101(m), video conferencing software systems did not exist.

<sup>53</sup> Tax-General Article § 11-219(b). Software or software as a service (SAAS) that requires significant creative input to customize, configure, or modify the procedures and programs that are necessary to perform the functions required for the software or SAAS to operate as intended are not subject to the sales and use tax.

- Revenue Management, Billing, Credit and Collection Systems
- Sales, Point of Sale (POS), Marketing, and Distribution Systems
- Customer Relationship Management Systems
- Data Management Systems
- Data Hosting, Archival, and Recovery Software and Systems
- IT Infrastructure and Application Management Systems
- Information Privacy and Security Software
- Risk Management Software
- Contract Management Software
- Productivity, Workflow and Project Management Systems
- Property Management Systems
- Reservation Systems, including hotel reservation systems, and Event Management Systems
- Business Intelligence, Analytics, and Modeling Software
- Collaboration, Video Conferencing, Email, and Messaging Systems
- Product lifecycle management, Product Innovation, Product Design, Product Development, and Product lifecycle software
- Manufacturing, warehousing, and equipment monitoring systems
- Healthcare and Medical Management systems
- Health and safety management systems
- Cloud Storage Services and Data Transfer Fees
- Video Conferencing Software Platforms
- Search Engine Optimization (“SEO”) Services

### Notification to Vendor

The sale of software that is customized, configured or modified and does not immediately perform the functions to operate as required by the buyer is exempt from the sales and use tax. The duty of the vendor to collect the sales and use tax is waived if the vendor performs the customization, configuration or modification of the software on behalf of the buyer.

If the customization, configuration or modification is done by the buyer or a third-party on behalf of the buyer, the buyer must notify the vendor that the software will be customized, configured or modified in order to operate as required by the buyer. If the buyer notifies the vendor, the duty of the vendor to collect the sales and use tax is waived.

If the buyer does not notify the vendor, the vendor should charge Maryland sales and use tax on the purchase price if the customer’s tax address is a Maryland address. The buyer’s notification to the vendor does not need to be in any particular form, but it shall state the following:

- name, address and federal employer identification number of the buyer;
- the purchase order or contract of purchase or other identification for the software to which the notification applies; and

- the purchased software will be customized, configured or modified in order to operate as intended.<sup>54</sup>

The vendor should retain a copy of the buyer's notification. The buyer must retain adequate records to support its statement to the vendor.

*Example 1* A vendor licenses a software package to an individual customer located in Maryland. The software package includes a broad array of business enabling products such as email, word processing, spreadsheets, presentations, storage, and retrieval products that are intended to interact seamlessly and can be operated as intended as soon as the software is accessed or installed. The software does not require configuration to use. The vendor is required to charge Maryland sales tax on this type of sales.

*Example 2* A vendor licenses software to a business customer located in Maryland. The software licenses include a broad array of business enabling products such as email, word processing, spreadsheets, presentations, collaborative environments, complex storage, and retrieval products that are intended to interact seamlessly and can be applied across an organization of nearly any size. In order for the customer to implement this functionality completely and securely, substantial configuration of the software is required in terms of interfacing with existing systems and these configurations are continually revised and adjusted as adaptations are made in the various elements of software and /or the customers use of that software in terms of scope and functionality.

Here, this licensed software does not operate as intended "out of the box" without this configuration activity. For example, the software must be able to integrate and work within the business enterprise environment in a secure manner, which requires significant initial and ongoing configuration to enable the software to work as intended. The vendor is not required to charge Maryland sales tax on this type of sales.

*Example 3* Software vendor A sells licenses for software to a customer headquartered in Maryland. The software can be hosted by the customer or by vendor A referred to as "SAAS". The software is not canned software, it does not work "out of the box," as configuration, customization, or modification is necessary to perform the functions required for the software to operate as intended.

The customer received bids from vendor B and vendor C to perform the required configuration, Vendor A does not bid on the configuration. As vendor B submitted the best bid, the customer engages vendor B to perform the required configuration.

Vendor A is not required to charge Maryland sales tax on the software licenses for the customer to host the software or for the customer use the software hosted in vendor A network (SAAS), as the software is not canned, it does not work "out of the box," as configuration, customization, or

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<sup>54</sup> If desired, the notification can reference Maryland statute Tax-General Article § 11-219 and Business Tax Tip #29.



modification is necessary to perform the functions required for the software to operate as intended.

Vendor B is not required to Charge Maryland sales tax on the software configuration services as it is a non-taxable service.

*Example 4* A vendor sells its hosted Ecommerce site operation software (also known as “SAAS” model software license) to businesses. The SAAS software is not canned software, it does not work “out of the box,” as configuration and modifications are required perform the functions required for the software to operate as intended. The customer must configure the software to provide information feeds to the vendor for the display of the customer’s products and to create specific check out features and integrations with the customer’s payment methods. Customer is headquartered in Maryland.

The vendor is not required to charge Maryland sales tax on the Ecommerce site operation SAAS software licenses, fees, or maintenance as it is not canned software, it does not work “out of the box”, as configuration, customization, or modification are necessary to perform the functions required for the software to operate as intended.

*Example 5* The vendor licenses software to a business customer headquartered in Maryland. The software licenses include a broad array of business enabling products such as email, word processing, spreadsheets, presentations, collaborative environments, complex storage, and retrieval products that are intended to interact seamlessly and can be applied across an organization of nearly any size. In order for the customer to implement this functionality completely and securely, substantial configuration is required in terms of interfacing with existing systems and these configurations are continually revised and adjusted as adaptations are made in the various elements of software and /or the customers use of that software in terms of scope and functionality. This licensed software does not operate as intended “out of the box” without this configuration activity. For example, the software must be able to integrate and work within the business enterprise environment in a secure manner, which requires significant initial and ongoing configuration to enable the software to work as intended. Vendor A is not required to charge Maryland sales tax on this type of sale.

The vendor licenses a similar functionality in a simpler software plan geared to individuals or a limited number of users in Maryland that does not require configuration to use. Vendor A is required to charge Maryland sales tax on this type of sales.

*Example 6* Buyer purchases SaaS from Vendor on the basis of a fee per user. Buyer is a company headquartered in Maryland with business operations at several locations in the United States. Vendor is a company headquartered in California with business operations at several locations in the United States. Vendor meets the criteria of Maryland COMAR 03.06.01.33 and engages in the business of an out-of-State vendor. The software application operates as intended without any required input to customize, configure, or modify. Buyer's purchase order issued to Vendor

indicates that Buyer's employees located at its Maryland headquarters will be the exclusive users of the software.

The SaaS transaction is a retail sale of a digital product.<sup>55</sup> Buyer's primary use location is in Maryland and is known by the Vendor.<sup>56</sup> Vendor is required to collect and remit sales and use tax on the fee.<sup>57</sup>

*Example 7* Buyer purchases SaaS from Vendor on the basis of a fee per user. Buyer is a company headquartered in Maryland with business operations at several locations in the United States. Vendor is a company headquartered in California with business operations at several locations in the United States. Vendor meets the criteria of Maryland COMAR 03.06.01.33 and engages in the business of an out-of-State vendor. The software application has off-the-shelf components, but it requires significant input to customize, configure, or modify it to allow the software application to operate as intended for this particular end user. Buyer's purchase order issued to Vendor indicates that Buyer's employees located at its Maryland headquarters will be the exclusive users of the software.

The SaaS transaction is a sale of custom computer software.<sup>58</sup> Although Buyer's primary use location is in Maryland and is known by the Vendor, Vendor is not required to collect and remit sales and use tax on the fee.<sup>59</sup>

*Example 8* Buyer purchases SaaS from Vendor on the basis of a fee per user. Buyer is a company headquartered in Maryland with business operations at several locations in the United States. Vendor is a company headquartered in California with business operations at several locations in the United States. Vendor meets the criteria of Maryland COMAR 03.06.01.33 and engages in the business of an out-of-State vendor. The software application operates as intended without any required input to customize, configure, or modify. Buyer's purchase order issued to Vendor indicates that the software will only be used by Buyer's employees at its Florida, Georgia and Texas locations.

The SaaS transaction is a retail sale of a digital product.<sup>60</sup> Buyer's primary use location is not in Maryland and is known by the Vendor.<sup>61</sup> Therefore, the SaaS transaction is not a retail sale in Maryland. Vendor is not required to collect and remit sales and use tax on the fee.<sup>62</sup>

*Example 9* Buyer purchases SaaS from vendor on the basis of a fee per user. Buyer is a company headquartered in Maryland with business operations at several locations in the United States.

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<sup>55</sup> Tax-General Article § 11-101 (c-4)(1); Tax-General Article § 11-101 (h)(2)(iv).

<sup>56</sup> Tax-General Article § 11-101 (e-1)(1)(ii); Tax-General Article § 11-101 (c-1)(2).

<sup>57</sup> Tax-General Article § 11-102 (a)(1); Tax-General Article § 11-401; Tax-General Article § 11-701; Tax-General Article § 11-101 (l)(1)(iii).

<sup>58</sup> Tax-General Article § 11-219 (b).

<sup>59</sup> Tax-General Article § 11-219 (b).

<sup>60</sup> Tax-General Article § 11-101 (c-4)(1); Tax-General Article § 11-101 (h)(2)(iv).

<sup>61</sup> Tax-General Article § 11-101 (e-1)(1)(ii); Tax-General Article § 11-101 (c-1)(2).

<sup>62</sup> Tax-General Article § 11-102 (a)(1).

Vendor is a company headquartered in California with business operations at several locations in the United States. Vendor meets the criteria of Maryland COMAR 03.06.01.33 and engages in the business of an out-of-State vendor. The software application operates as intended without any required input to customize, configure, or modify. Buyer's purchase order issued to Vendor is silent concerning which of its employees will be the users of the software. However, the Buyer's purchase order indicates that the particular purchaser is Buyer's division located in Colorado and Buyer's purchase order further contains a "Ship To" address for the Buyer's division located in Colorado.

The SaaS transaction is a retail sale of a digital product.<sup>63</sup> Buyer's primary use location is not known by the Vendor, but the vendor's business records do specify an address in Colorado for the buyer.<sup>64</sup> Therefore, the SaaS transaction is not a retail sale in Maryland. The vendor is not required to collect and remit sales and use tax on the fee.<sup>65</sup>

*Example 10* Vendor sells its hosted Ecommerce site operation software (also known as "SAAS" model software license) to businesses. The SAAS software is not canned software, it does not work "out of the box," as configuration and modifications are required perform the functions required for the software to operate as intended. The customer must configure the software to provide information feeds to the vendor for the display of the customer's products and to create specific check out features and integrations with customer's payment methods. The customer is headquartered in Maryland.

Here, the vendor is not required to charge Maryland sales tax on the Ecommerce site operation SAAS software licenses, fees, or maintenance as it is not canned software, it does not work "out of the box", as configuration, customization, or modification are necessary to perform the functions required for the software to operate as intended.

### Computer Programs for Resale

The sales and use tax does not apply to a sale of a computer program that is legally permitted to be and is intended to be reproduced for sale or incorporated in whole or in part into another computer program intended for sale.<sup>66</sup>

## Video Games

A charge to access, download, stream or use video or online games is subject to the sales and use tax. A charge to access, download, stream or use virtual items, such as avatars, backgrounds, skins, renders and in-app purchases, purchased for use in a video or online game is also subject to the sales and use tax.

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<sup>63</sup> Tax-General Article § 11-101 (c-4)(1); Tax-General Article § 11-101 (h)(2)(iv).

<sup>64</sup> Tax-General Article § 11-101 (e-1)(1)(ii); Tax-General Article § 11-101 (c-1)(4).

<sup>65</sup> Tax-General Article § 11-102 (a)(1).

<sup>66</sup> Tax-General Article § 11-225.

## Exclusions for Sales to Non-End Users and for Resale of a Digital Code or a Digital Product

Sales and use tax only applies to the sale or use of digital product by an end user.<sup>67</sup> Thus, the sales and use tax does not apply to a sale to a person that “receives a digital code or digital product for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution, or exhibition of the digital product.”<sup>68</sup>

A person may claim the resale exclusion and avoid payment of the sales and use tax on the purchase of a digital product if purchased with the intention of:

- reselling the digital product in the same form that the buyer receives or is to receive the digital product;<sup>69</sup>
- incorporating the digital product into another digital product intended for resale;<sup>70</sup>
- transferring that digital product to a buyer in the form of a taxable service;<sup>71</sup> or
- incorporating the digital product into a physical product.<sup>72</sup>

The same requirements for obtaining, use, and record retention of resale certificates for tangible personal property applies to digital products. For more information on Maryland’s resale certificate requirements, please see [COMAR 03.03.06.01.14](#).

## Exemptions to the Sale of Digital Codes and Digital Products

The sale of a digital code or a digital product is subject to the sales and use tax unless an exemption applies to the transaction. A sales and use tax exemption applies to the sale of a digital code or a digital product unless the exemption statute specifically exempts only tangible personal property, a taxable service or a specific item.

### Agricultural

The sales and use tax does not apply to a sale of the farm equipment to a farmer for an agricultural purpose if the farm equipment is used to raise livestock, prepare, irrigate, or tend the soil or plant, service, harvest, store, clean, dry, or transport seeds or crops.<sup>73</sup> A digital product such as software sold to a farmer used to operate farm equipment used for an agricultural purpose is exempt from the sales and use tax.

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<sup>67</sup> Tax-General Article § 11-101(c-5).

<sup>68</sup> *Id.*

<sup>69</sup> Tax-General Article § 11-101(n)(3)(ii)(1).

<sup>70</sup> Tax-General Article § 11-101(h)(3)(ii)(3); Tax-General Article § 11-101(n)(3)(ii)(2).

<sup>71</sup> Tax-General Article § 11-101(h)(3)(ii)(3); Tax-General Article § 11-101(n)(3)(ii)(3).

<sup>72</sup> Tax-General Article § 11-101(h)(3)(ii)(2).

<sup>73</sup> Tax-General Article § 11-201(a)(6)(v).

## Casual and Isolated Sales and Distributions and Transfers

The sales and use tax does not apply to a casual and isolated sale by a person who regularly does not sell tangible personal property, a digital code, a digital product, or a taxable service if the sale price is less than \$1,000 and the sale is not made through an auctioneer or a dealer.<sup>74</sup>

The sales and use tax does not apply to a distribution of tangible personal property, a digital code, or a digital product by:

- a corporation or joint-stock company to its stockholders as a liquidating distribution;
- a partnership to a partner; or
- a limited liability company to a member.<sup>75</sup>

The sales and use tax does not apply to a transfer of tangible personal property, a digital code, or a digital product:

- under a reorganization within the meaning of § 368(a) of the Internal Revenue Code;
- on organization of a corporation or joint-stock company, to the corporation or company principally in consideration for the issuance of its stock;
- to a partnership only as a contribution to its capital or in consideration for a partnership interest in the partnership; or
- to a limited liability company only as a capital contribution or inconsideration for an interest in the limited liability company.<sup>76</sup>

## Construction with other tax laws

HB 932 amended Tax-General Article § 11-221 to state that the retail sale of a digital product subject to Title 11. Sales and use tax does not include the retail sale that is subject to tax in accordance with any other provision of the Tax-General Article.”<sup>77</sup> Tax-General Article § 11-221 was revised to expand the exemption for sales of tangible personal property or taxable services acquired by a buyer who pays another state a tax on a sale or gross receipts from a sale before entering Maryland to sales of digital codes and digital products. Therefore, a buyer who pays another state a tax on a sale of a digital code or a digital product before entering Maryland is not required to pay use tax for a use in Maryland of a digital code or digital product.<sup>78</sup> However, if the tax paid to another state is less than the sales and use tax, the buyer shall pay the difference between the sales and use tax and the amount paid to the other state.<sup>79</sup>

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<sup>74</sup> Tax-General Article § 11-209(a).

<sup>75</sup> Tax-General Article § 11-209(b).

<sup>76</sup> Tax-General Article § 11-209(c).

<sup>77</sup> Tax-General Article § 11-221(d).

<sup>78</sup> Tax-General Article § 11

<sup>79</sup> The tax is paid according to the formula in Tax-General Article § 11-303(b).

## Exempt organizations

There is no general exemption for all sales made by exempt organizations under Maryland law. Therefore, unless a specific exemption exists,<sup>80</sup> exempt organizations must charge sales tax on a sale of a digital product. However, a charge for viewing or attending live continuing education classes, seminars or conferences provided electronically is not subject to sales and use tax if sold by a non-profit organization or business association.

An exempt organization may purchase a digital product tax-free if the exempt organization has a valid exemption certificate issued by the Maryland Comptroller's office.<sup>81</sup>

## Film Production Activities

The sales and use tax does not apply to a sale of tangible personal property, a digital code, a digital product, or a taxable service used directly in connection with a film production activity by a film producer or production company certified by the Department of Commerce.<sup>82</sup>

## Government Sales

The sale of a digital code or a digital product to the federal government, the State or a political subdivision of the State is exempt from the sales and use tax.<sup>83</sup>

## Interstate Commerce

The sales and use tax does not apply to a sale of film, video tape, or a digital product for use only in television broadcasting by a television station that the Federal Communications Commission licenses specifically to broadcast to a city or town outside the State.<sup>84</sup> The sales and use tax does not apply to a sale of a replacement part, other tangible personal property, or a digital product to be used physically in, on, or by a conveyance in an aircraft, motor vehicle, railroad rolling stock, or vessel that is used principally to cross State lines in interstate or foreign commerce.<sup>85</sup>

## Nonresident Property

The sales and use tax does not apply to use of tangible personal property, a digital code, a digital product, or a taxable service that:

- (1) a nonresident
  - a. acquires before the property, digital code, digital product, or service enters the State; and

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<sup>80</sup> See Tax-General Article § 11-204(b).

<sup>81</sup> Tax-General Article § 11-204.

<sup>82</sup> Tax-General Article § 11-227.

<sup>83</sup> Tax-General Article § 11-220(a).

<sup>84</sup> Tax-General Article § 11-208(b).

<sup>85</sup> Tax-General Article § 11-208(c)(1-2).

- b. a nonresident uses for personal enjoyment or use or for a use other than for a business purpose; or in a presentation or in conjunction with a presentation of an exhibit, show, sporting event, or other public performance or display; and
- (2) does not remain in the State for more than 30 days.<sup>86</sup>

## Parent Teacher Organizations

The sales and use tax does not apply to a sale of tangible personal property, a digital code, or a digital product to a nonprofit parent-teacher association located in the State if the association makes the purchase to contribute the property to a school to which a sale is exempt.<sup>87</sup>

## Production Activity

The definition of “production activity” is narrowly defined under Maryland law.<sup>88</sup> Production activity is limited to certain activities<sup>89</sup> defined by statute, including “assembling, manufacturing, processing, or refining tangible personal property for resale.”<sup>90</sup> Production activity has not historically included the creation of digital products and HB 932 did not alter the definition of production activity to include digital products. Therefore, the purchase of tangible personal property used to create digital products and digital code does not qualify for the exemption for sales of tangible personal property used in a production activity.

The purchase of a tangible personal property, digital code or a digital product used in a production activity to create tangible personal property qualifies for the exemption.<sup>91</sup> The sales and use tax also does not apply to the sale of a digital product in a production activity as a material or part of other tangible personal property or another digital product to be produced for sale.<sup>92</sup>

*Example 1* A Maryland company manufactures auto parts. The company has purchased equipment that turns raw materials into specific parts for sale. The equipment relies on software to move and cut the raw materials. The software is not customized by the software vendor and does not interact with the company’s enterprise computer system. The equipment and the software to operate the equipment is not subject to the sales and use tax because they qualify for the production activity exemption.

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<sup>86</sup> Tax-General Article § 11-214.

<sup>87</sup> Tax-General Article § 11-204(a)(6).

<sup>88</sup> Tax-General Article § 11-101(f)(1).

<sup>89</sup> Tax-General Article § 11-101(f)(1)(ii-vii).

<sup>90</sup> Tax-General Article § 11-101(f)(1)(i).

<sup>91</sup> Tax-General Article § 11-210.

<sup>92</sup> Tax-General Article § 11-101.

## Property for Use in Another State

The sales and use tax does not apply to a sale for use of tangible personal property, a digital code, or a digital product that:

- is bought outside this State;
- is intended solely for use in another state; and
- is stored in this State pending shipment to another state.<sup>93</sup>

Except for that portion of the purchase price allocable to intended viewing in Maryland, the sales and use tax does not apply to a sale of a series of images stored on video tape or in other optical or digital forms or electronic signals generated from these images to a cable or other nonbroadcast television network, if the images are intended for viewing by television viewers located outside of Maryland.<sup>94</sup>

## Research and Development

The sales and use tax does not apply to a sale of tangible personal property, a digital code or a digital product for use or consumption in research and development.<sup>95</sup>

## Marketplace Facilitators

A marketplace facilitator shall collect the applicable sales and use tax due on a retail sale or sale for use by a marketplace seller to a buyer in Maryland. A person qualifies as a marketplace facilitator if that the person lists or advertises digital codes, digital products or tangible personal property for sale in a marketplace.<sup>96</sup> A marketplace facilitator is required to collect sales tax on the sales of digital codes, digital products, and tangible personal property on behalf of the marketplace seller if the marketplace facilitator facilitates retail sales by listing or advertising for sale digital codes, digital products or tangible personal property in a marketplace.<sup>97</sup>

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<sup>93</sup> Tax-General Article § 11-216(a)(1).

<sup>94</sup> Tax-General Article § 11-216(a)(3).

<sup>95</sup> Tax-General Article § 11-217(b).

<sup>96</sup> Tax-General Article § 11-101(c-2)(1)(i).

<sup>97</sup> “Marketplace facilitator” means a person that: (i) facilitates a retail sale by a marketplace seller by listing or advertising for sale in a marketplace tangible personal property, digital code, or a digital product; and (ii) regardless of whether the person receives compensation or other consideration in exchange for the person's services, directly or indirectly through agreements with third parties, collects payment from a buyer and transmits the payment to the marketplace seller. Tax-General Article § 11-101(c-2)(1). “Marketplace seller” means a person that makes a retail sale or sale for use through a physical or electronic marketplace operated by a marketplace facilitator. Tax-General Article § 11-101(c-3).



## Nexus

### Out-of-State Vendors

A person who engages in the business of an out-of-State vendor shall collect and remit sales and use tax on all taxable sales of digital codes or digital products for use in Maryland. A person engages in the business of an out-of-State vendor if the person meets the criteria of Maryland [COMAR 03.06.01.33](#).<sup>98</sup> An out-of-State vendor includes a person who sells digital codes or digital products for delivery in Maryland if, during the previous calendar year or the current calendar year, the person satisfies either of the following criteria:

- (a) The person's gross revenue from the sale of digital codes or digital products code delivered in the State exceeds \$100,000.00; or
- (b) The person sold digital codes or digital products for delivery into the State in 200 or more separate transactions.<sup>99</sup>

If you are an out-of-state vendor and are required to register to collect sales and use tax, please file a combined registration application available [here](#).

### Sourcing of Sales of Digital Codes or Digital Products

The retail sale of a digital code or a digital product shall be presumed to be made in the state in which the customer tax address is located.<sup>100</sup>

#### Customer Tax Address

The "customer tax address" for the sale of a digital code or digital product means:

1. the address of the vendor's business location if the digital code or digital product is received by a buyer at the business location of the vendor;
2. the address of the primary use location if the buyer does not receive the digital code or digital product at the vendor's business location and the vendor knows the primary use location of the digital code or digital product;
3. If item 1 and item 2 do not apply, the location where the digital code or digital product is received by the buyer or by a donee of the buyer if identified by the buyer and if known to the vendor and maintained in the ordinary course of the vendor's business;
4. If items 1 through 3 do not apply, the location indicated by an address for the buyer that is available from the business records of the vendor that are maintained in the ordinary course of business, if the address does not constitute bad faith;

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<sup>98</sup> COMAR 03.06.01.33(B)(5).

<sup>99</sup> For purposes of determining nexus under COMAR 03.06.01.33(B)(5), out-of-state vendors were not required include sales of digital code and digital products in their calculation of threshold amounts until March 14, 2021.

<sup>100</sup> Tax-General Article § 11-103(C).

5. If items 1 through 4 do not apply, the location of the address of the buyer provided during the consummation of the sale, including the address of the buyer's payment instrument, when use of the address does not constitute bad faith; or
6. If items 1 through 5 do not apply, including a circumstance in which a vendor does not have sufficient information to apply those items, one of the following locations as selected by the vendor, provided that the location is consistently used by the vendor for all sales to which this item applies:
  - The location in the United States of the headquarters of the vendor's business;
  - The location in the United States where the vendor has the greatest number of employees; or
  - The location in the United States from which the vendor makes digital codes or digital products available for electronic transfer.<sup>101</sup>

### Primary Use Location

Primary use location means the street address representative of where the buyer's use of a digital code or digital product will primarily occur, as determined by:

1. The residential street address or a business street address of the actual end user of the digital code or digital product, including, if applicable, the address of a donee of the buyer that is designated by the buyer; or
2. If the buyer is not an individual, the location of the buyer's employees or equipment that makes use of the digital code or digital product.<sup>102</sup>

Primary use location does not include the location of a person who used a digital code or digital product as the purchaser of a separate good or service from the buyer.<sup>103</sup>

### Digital Codes and Digital Products Used in Multiple States

The sale of a digital code or digital product to a business with multiple locations within and outside of Maryland must be sourced to "the location of the buyer's employees or equipment that makes use of the digital code or digital product." Therefore, if a digital code or digital product will be used a buyer's employees or equipment in multiple states, the sale is subject to Maryland sales and use tax to the extent used by employees or equipment in Maryland.

A buyer of a digital code or a digital product that will be used in multiple states must determine the percentage of employees or equipment in and outside of Maryland using a reasonable methodology and notify the vendor the percentage of use in Maryland. If the buyer provides the vendor with a written statement at the time of the sale, the vendor may charge Maryland sales and use tax based on the percentage of use in Maryland. The statement does not need to be in

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<sup>101</sup> Tax-General Article § 11-101(C-1).

<sup>102</sup> Tax-General Article § 11-101(E-1).

<sup>103</sup> Tax-General Article § 11-101(E-2).

any particular form, but it shall state the percentage of use by employees or equipment in Maryland.

If the vendor is unable to charge Maryland sales and use tax based on a percentage of the total sales, the vendor's duty to charge and collect is not waived if the buyer notifies the vendor that the buyer will remit use tax on the purchase.<sup>104</sup> The vendor should charge Maryland sales and use tax on the total sales price and the buyer may file a refund claim of sales and use tax paid on the percentage of use outside of Maryland.

#### *Example 1*

Vendor licenses software to a business customer headquartered in Maryland. Buyer has business operations at several locations in the United States. Buyer has determined that 45% of the software licenses will be used by equipment or employees located in Maryland. The remainder of the software licenses will be used by equipment and employees located outside of Maryland. Buyer provides Vendor with a letter that states that the software will be licensed for multiple points of use by Buyer's equipment and employees. Vendor is required to charge Maryland sales tax on 45% of the invoice to Buyer. Vendor must retain a copy of the letter provided by the Buyer.

## **Sales of Digital Codes and Digital Products Prior to the Effective Date**

A sale is a transaction for the present or future transfer of title or possession of a digital code or digital product, for a consideration, and the tax imposed on a retail sale applies when the transaction is entered into, regardless of when the consideration is to be paid, the digital code or digital product is to be delivered.<sup>105</sup> Except for a license of a digital product, the vendor shall collect the tax from the buyer when the sale occurs.<sup>106</sup>

*Example 1* A business purchases a two-year subscription to access an electronically delivered canned software product on March 1, 2021. The sales and use tax did not apply to the sale of a digital product prior to March 14, 2021. The sales tax does not apply to the sale on March 1, 2021. The business is not required to accrue use tax on the portion of the subscription plan accessed after March 14, 2021.

*Example 2* A business purchases a license to access electronically delivered canned software product on March 1, 2021. The license is renewed on a monthly basis. The sales and use tax did not apply to the sale of a digital product prior to March 14, 2021. Thus, the sales tax does not

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<sup>104</sup> A buyer shall pay the sales and use tax to the vendor unless a buyer is otherwise required by regulation to pay the sales and use tax directly to the Comptroller's office. Tax-General Article § 11-403(c). The Comptroller's office has not issued a regulation that permits or requires the buyer of digital code or digital product to pay the sales and use tax directly to the Comptroller's office.

<sup>105</sup> COMAR 03.06.01.21.

<sup>106</sup> *Id.*

apply to the charge for the monthly software license on March 1, 2021. However, the sales and use tax applies to the charge for the monthly software license on April 1, 2021.

*Example 3* A business enters into a contract to receive electronically delivered digital products on December 1, 2020. The digital products are not scheduled to be delivered until April 1, 2021. Payment is due under the contract on June 1, 2021. The sales and use tax does not apply to the sale of the digital products because the sale occurred on the contract date of December 1, 2020.