



Taxation of Digital Products Uniformity Project

Discussion of Outline for White Paper Section on Bundling

Presentation to the Uniformity Committee – July 30, 2024

The Digital Products Work Group was formed to draft a white paper on the issues states should consider when including digital products in their sales tax base. As part of that larger white paper, we propose a subsection addressing bundling issues.

We present this proposed outline for the committee's feedback, in particular to identify necessary subtopics. This will allow us to move forward with a draft that we expect will be shared for discussion at the September 5 digital products work group meeting. The order and formatting may change through the drafting process, additional information may be received from other stakeholders, or staff may uncover additional relevant research related to bundling and digital products.

State representatives, notably the work group members, and other stakeholders will have a chance to review and comment on the draft to help produce guidance for policymakers.

Please direct any questions or feedback to Nancy Prosser, nprosser@mtc.gov, or Jonathan White, jwhite@mtc.gov

The primary question this section of the digital products white paper would address is: Does the presence of digital products in a sales and use tax base present any unique issues with respect to bundling compared to sales and use tax bases that are based on tangible personal property and services?

- 1. Brief background and history explaining why and how states have developed bundling rules.**
 - a. Streamlined states
 - b. Non-streamlined states
 - c. Note on terminology

2. **Results of staff research into current state practices on bundling.**
 - a. Streamlined states
 - b. Non-streamlined states
3. **Results of stakeholder discussions about bundling and digital products.**
4. **Examples of digital products in the marketplace and bundling issues.**
5. **Approaches to addressing bundling issues.**
 - a. Tainting rule – Any taxable component in a bundle means the whole bundle is taxable.
 - i. Pros: Easy for sellers to apply and explain to purchasers; less audit risk.
 - ii. Cons: Purchasers may push back and not want to pay tax on the full amount.
 - b. De minimis rule (most likely exception to the tainting rule):
 - i. Can taxability be determined based on verifiable cost information of the bundled products?
 - ii. What costs control – input or output costs? May be harder to determine in the digital realm when there are fewer comparison products available.
 - iii. What should the threshold be? Is 5-10% too low to make a difference? Is 20% better to allow taxpayers and tax administrators to feel more comfortable about the outcome?
 - iv. What is the philosophy behind any de minimis rule? Does the use of a de minimis rule make it difficult for a bundle to escape taxation once something taxable is included in the bundle? Does a de minimis rule create fairness? If so, should it should be high enough that when the de minimis amount is exceeded it won't seem unreasonable to tax the entire cost of the bundle?
 - v. Consider SST Section 330. D. 3. as a guideline to establish a % taxability of a bundle that could also serve as a rebuttable or irrebuttable presumption.
 - c. Streamlined Agreement and related rules

- d. Accounting rule (unbundling) – Sellers can charge a single price for a bundled product and only collect tax on the taxable parts based on a reasonable position consistently taken and documented in books and records.
 - i. Pros: The preferred approach of the telecom industry; also memorialized in ITFA and MTSA federal laws. May work well for businesses that want to market a single price for a product it thinks is important for market share.
 - ii. Cons: May have more audit risk. Not easy for 3rd party compliance vendors to program in their systems. Definition of “bundle” is critical.
- e. Hierarchy – A new way to think about giving sellers, purchasers, and tax administrators tools to address bundling, with an ultimate default to taxable?
- f. True object (default rule) – Whose perspective controls the true object analysis? The seller’s or purchaser’s? Possibly consider a “reasonably prudent buyer” rule.
- g. Industry specific:
 - i. Already present in the SST approach
 - ii. Telecom industry in all states benefits from the accounting rules in ITFA and MTSA
- h. Deciding between the various approaches
 - i. Questions states will have to answer to determine their approach
 - ii. Balancing the pros and cons of each approach
 - iii. Supporting provisions for each approach

6. Federal law considerations

- a. ITFA
- b. MTSA

7. Lessons learned and other considerations for policy makers

This section will highlight the questions policy makers should consider in creating a coherent policy framework for bundling in the digital space.

- a. Tax software compliance coding – Bundling issues can make coding much harder.

- b. Definitions - What is a bundle versus what is a single digital product composed of a group of digital attributes? In the digital realm, digital components can be easily stripped out or added, which can lead to disputes and long discussions with tax agency staff who may be skeptical about the nature of the product and how it works.

- c. Invoices vs. contracts – Greater details may exist in a contract about what is being purchased and how the product works to help auditors and tax agency staff; lack of such detail may result in unwillingness of tax agency staff to allow unbundling through an accounting rule.

8. Findings and conclusions

9. Recommendations to the states (if any) - to be determined once the whitepaper is completed