



MULTISTATE TAX COMMISSION

MEETING NOTES

MTC Work Group – Sales Taxation of Digital Products

July 11, 2024

**[See also the presentation slides for this meeting on the project page – here:
<https://www.mtc.gov/uniformity/sales-tax-on-digital-products/>]**

I. Welcome/Introductions/Review of Notes from June 6, 2024 Work Group Call

Tim Jennrich (Washington), Chair of the Work Group, convened the meeting and provided brief introductory information on the work group and its process. He also noted that the process guidelines and notes were posted in the chat and online and would move along to the agenda items.

II. Initial Public Comment

Jennrich invited any initial public comments. There were none.

III. Plans for Uniformity Committee meeting in Denver on July 30, 2024

Jennrich noted that there would be two things for the group on the committee agenda. The first would be a status report on bundling and possible work session. The second would be a panel of representatives of NCSL, Streamlined, FTA, and the MTC to discuss how the organizations will be working on related issues. He also noted that if anyone had input on the agenda, please reach out.

IV. Next work group meeting is September 5, 2024

Jennrich noted that there will be no August meeting.

V. Update on staff research relating to bundling and digital products

Jonathan White, MTC, noted that he was continuing his presentation from the last call using slides to illustrate the issues with respect to bundling generally and digital products. He noted the point of the presentation was to generate questions and comments. Also, the slides are being edited as discussion goes on.

To recap, he noted that on the last call he summarized the basic questions that we are trying to answer. He also noted that he was planning on having input from the participants. He noted that the first example—lemonade—was meant to show that if you can't unbundle something, then it's not a bundle. He then noted that the general default presumption is that if there is a bundle of items that are taxable or not taxable—the whole transaction is taxable and that this is often tied to the definition of "sales price."

Jennrich noted that the term "sales price" might be different in different states. In Washington, for example, the sales price might be narrower. Jonathan agreed that this generally appears to be the case for Streamlined states as well. He noted that the definition

of sales price is going to be the place where states start and will determine the need for a bundling provision.

Some states also define “bundle” or designate what a bundle is. In general, it’s a single price for different items. He noted that when Streamlined developed their rule, they followed this general approach—looking at the single price for multiple different items. The main example is the combination of food in a bundle with other things, like a serving tray. He asked if anyone had thoughts about that example. He also noted another example involving subscriptions, and asked in particular whether this approach might be the right answer for tax administrators or in terms of tax policy. Mark Nebergall, Software Finance, asked how to distinguish a “tray” from regular packaging. White noted that this was a good point—you have to draw a line between a product and packaging.

Craig Johnson, Streamlined, noted that this relates to the definition of “distinct and identifiable products” and this is the way that packaging is excluded from the bundling rule. Jonathan then asked again, is there a difference in the subscription example? Nebergall commented that this is what makes some of the bundling discussion difficult. Nebergall also noted that this is the difference between a “bundling rule” and an “unbundling rule.”

Jennrich noted that in the case of the subscription example, the products seem distinct and identifiable. But this seems more complicated in the digital context. So, it may be harder to separate those digital products. And under the Streamlined “unbundling” rule, this begs the question of how to separate them. So, this is murkier.

Nebergall asked whether there would be any other questions raised here other than whether the items are “distinct and identifiable” and whether cost of the items would make any difference. White noted that the de minimis rule might apply but was not the focus here. Nebergall noted that on the last call he asked—when does a feature become a product. The issue is whether you can take a feature and sell it separately.

Diane Yetter, Sales Tax Institute, noted that in the digital space, like managed IT service contracts or hosting contracts, the invoice may be a single line, but the components are separately stated in the contract, along with separate prices. So, is that still a bundle—even though the invoice may only list a single combined item? Nebergall noted that a “single itemized price” is defined by Streamlined and that this would fall outside that definition. Deborah Bierbaum noted that she agreed with that interpretation.

White also noted that the Streamlined rule has a number of exceptions. One of those is the true object test. This applies to services which have an “essential” piece of tangible personal property not available for sale otherwise. Basically, this seems to indicate that the true object test is an exception to the Streamlined bundling rule. An example is the cable box which is provided with the cable service.

White then talked more about the true object test under adjudicatory interpretations or common law. He noted a couple examples of those interpretations. The true object looks to the product’s purpose, not its production. And the true object test often determines the treatment of the whole transaction. And it looks to the purchaser’s (or reasonable purchaser’s) intent or purpose.

White also noted that there are examples where the true object test is not an all-or-nothing test—but depends then on the application of any specific bundling rule provisions, using Tennessee’s law and guidance for examples. So, for example, under Tennessee law, the use of “essential” items is different than its use under Streamlined. The results in those cases might not be all-or-nothing. Jennrich asked whether any non-Streamlined state would have a similar result under their rules.

White talked about other non-Streamlined examples. He noted that in these examples, the items were priced separately but billed together. The result was dependent on the fact that the purchaser wanted both things and that those things were readily separable. So, there was no application of the true object test to the entire thing. In another example, White noted that a court in California looked to whether the items are separable—in which case—the true object test does not apply. White then questioned whether this is just an example of the application of a more nuanced true object test.

Ray Langenberg, Texas, noted that the Streamlined rule has an extensive definition of a bundled transaction and that this has been studied extensively by that group. He queried whether that rule set the standard for uniformity. He asked, therefore, what is our role here? He noted that the group could simply summarize the Streamlined rule and note what other states do. What should this group be doing to advance the ball? Are we otherwise invading the Streamlined territory? He would recommend that we simply summarize the rules.

White noted that he was at the end of his discussion and that this was an appropriate question. Jennrich noted that he didn’t disagree. But he mentioned that the Streamlined rule was developed before widespread expansion of digital products. So, he would see a focus on those issues as the best place to focus. He noted that these transactions might be more difficult to unbundle. In addition, states have to think about ITFA. So, the white paper could also note the challenges in this area.

Nebergall noted that he doesn’t disagree with the focus here. For him, the question is where state rules produce a result different from the Streamlined rule.

Johnson noted that from a Streamlined perspective he would like to hear where the Streamlined rule has problems that they could investigate. He would urge states to look at the Streamlined rules and ask how their rules differ and why. Then they could give input. And also—are there issues that they are seeing that the Streamlined rule doesn’t adequately address.

Nebergall noted that he was also around when the Streamlined rule was developed. His impression is that those rules work well and also work in the context of digital products.

Nancy Prosser, MTC, noted that MTC staff have also wrapped up the stakeholder interviews on bundling and will be presenting that information in the future, which should be helpful to this discussion on bundling issues.

VI. Other business

There was no other business.

VII. Adjourn

Jennrich concluded the meeting.

