MTC Project on Taxing Digital Products
Study Group Bundling Exercise

Background

The MTC digital products work group was established to write a white paper for policymakers on issues that states should consider when deciding whether and how to subject digital products to sales tax. The work group has recently been studying the issue of bundled transactions and, specifically, whether digital goods may have an effect on how states handle these transactions.

- **"Bundling"** – The term "bundling" generally refers to separate products being sold for a single combined price. If products subject to different tax treatments are included in a bundled transaction, then the tax treatment of the bundled transaction may be impacted.
- **Bundling is the result of product-based tax distinctions** – Whenever state sales taxes distinguish what is or is not taxable based on definitions or descriptions of the products, this can create bundling issues. And because states have long excluded or exempted different products from sales tax (including certain types of property and services), states have had to develop rules and methods for handling bundled or similar transactions. Those rules and their application are summarized in a draft write up, here: Bundling Section Draft.
- **Excluding digital products from tax creates bundling issues** – It is not primarily the inclusion of digital products in the taxable base but their exclusion that is likely to create bundling issues, as when transactions include both nontaxable digital goods and other products that are subject to tax (e.g. tangible personal property or certain taxable services).
- **Streamlined bundling rules** - The Streamlined Sales Tax Governing Board (Streamlined) studied bundling in the past and adopted provisions addressing the issue as part of the Streamlined Sales and Use Tax Agreement and governing board administrative rules. Other states may have taken different approaches to bundled transactions but generally do not have rules that are as developed.

Why are We Doing This Exercise?

We are asking participants to apply the Streamlined bundling rules to several examples (below) that include digital products. We are doing this exercise to determine if digital products, broadly construed, present problems that the Streamlined bundling rules do not sufficiently address. This will serve as feedback to Streamlined on any changes they may want to consider to those rules.

Questions to Keep in Mind

Are the existing Streamlined rules sufficient to address bundling issues involving digital products?
Do digital products raise unique issues that may require different rules or approaches?

Streamlined Rules

Included with this document and the examples below is a separate document with the Streamlined rules along with a decision-tree taken from the Wisconsin sales tax guide. Depending on your familiarity with the Streamlined rules, it may be best to study the decision-tree and accompanying notes before moving to the examples.

EXAMPLES:

Note that each of the six examples below has its own facts and assumptions that should be taken into account. If these facts and assumptions are not sufficient to determine the treatment under the Streamlined bundling rules, please note what information you believe is necessary for that determination.

Example 1

Facts:

- Seller A sells a software as a service platform that allows purchasers to create 3D renderings of buildings or structures that can be downloaded or shared via email. The advertised sales price for the platform is $100 for a monthly subscription.
- Seller A also sells a prewritten computer application that allows purchasers to more easily access the platform. The advertised price for one license is $10.
- The Seller packages both platform and application together for a price of $110.
- Purchaser B purchases the package for $110.

Assumptions:

- The state generally taxes tangible personal property and includes prewritten software in its definition of tangible personal property.
- The state does not tax software as a service.

Questions:

a) Is the transaction a bundled transaction?
   i) Is there one or more "distinct and identifiable" products? If so, what are they?
   ii) Is there one nonitemized price? If so, what is the price?
   iii) Does the sales price vary or is it separately negotiable based on purchaser selection? If so, how does that impact the result?

b) Did you encounter challenges or have questions in applying the bundling analysis to the example?

NOTE: If your own state's approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

a) Differences in the approach to bundling used by your state, or
b) Differences between the assumptions here and your own state's tax laws.

Example 2

Facts:

- Seller C sells digital music/songs for permanent use, which may be downloaded and stored on the purchaser's own device. The advertised price is $1.00 per song, which includes a $0.10 delivery fee.
- Seller C also sells it "musical delight" package that includes a pair of ear buds, access to a music streaming service that provides purchasers with access to a library of music and established stations, and a downloadable prewritten computer software application that plays music files. The advertised price for the package is $210, which includes a $10 delivery fee.
  - With the purchase of a package, the purchaser can select and receive one collectible bobblehead displaying any one of five featured musical artists. Purchasers pay $210 regardless of whether they select a bobblehead.
- Customer D purchases 20 songs by its favorite artist, the musical delight package, and selects a Mozart bobblehead, all for $230.

Assumptions:

- The state generally taxes tangible personal property and includes prewritten software in its definition of tangible personal property.
- The state taxes digital music downloads for permanent use.
- The state does not tax streaming services.

Questions:

a) Is the transaction a bundled transaction?
   i) Is there one or more "distinct and identifiable" products? If so, what are they?
   ii) Is there one nonitemized price? If so, what is the price?
   iii) Does the sales price vary or is it separately negotiable based on the purchaser's selection? If so, how does that impact the result?

b) Did you encounter challenges or have questions in applying the bundling analysis to the example?

NOTE: If your own state's approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

c) Differences in the approach to bundling used by your state, or
d) Differences between the assumptions here and your own state's tax laws.

Example 3

Facts:

- Seller E sells a human resources intelligence package to businesses that need human resources support. The package provides purchasers with access to a digital research library service where purchasers can research human resource issues, access to prerecorded audio-visual presentations and trainings on human resources topics, and professional consulting services of up to 50 hours. The advertised price for the package is $10,000.
- None of the items in the package can be purchased separately, except that purchasers can buy additional consulting hours for a separate fee.
- Purchaser F buys the package.

Assumptions:

- The state taxes audio-visual works including recorded presentations and trainings.
- The state does not tax services transferred electronically or professional services.

Questions:

a) Is the transaction a bundled transaction?
   i) Is there one or more “distinct and identifiable” products? If so, what are they?
   ii) Is there one nonitemized price? If so, what is the price?
   iii) Does the sales price vary or is it separately negotiable based on purchaser selection? If so, how does that impact the result?

b) Does this example present an exception to the Streamlined definition of a bundled transaction?

c) Did you encounter challenges or have questions in applying the bundling analysis to the example?

NOTE: If your own state’s approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

e) Differences in the approach to bundling used by your state, or
f) Differences between the assumptions here and your own state’s tax laws.

Example 4

Facts:

- Seller G creates an integrated online retail store for retailers. The offering includes: (1) services to design and create retail websites, listed for a price of $1,000; (2) order processing, listed for a price of $1,000; (3) payment processing, listed for a price of $1,000, (4) hosting, listed for a price of $1,000, (5) firewall, antivirus tools, and incident tracking, listed for a price of $1,000, and (6) storage, listed for a price of $1,000. The advertised price for the package is $6,000.
- None of the items in the package can be purchased separately except the firewall, antivirus tools, and incident tracking. These are sold as a stand-alone package priced at $2,000.
- Purchaser H purchases the package.

Assumptions:

- The state taxes website design and creation services and firewall services.
- The state does not tax order processing, payment processing, hosting, or storage.

Questions:

a) Is the transaction a bundled transaction?
   i) Is there one or more “distinct and identifiable” products? If so, what are they?
   ii) Is there one nonitemized price? If so, what is the price?
   iii) Does the sales price vary or is it separately negotiable based on purchaser selection? If so, how does that impact the result?

b) Does this example present an exception to the Streamlined definition of a bundled transaction?

c) Did you encounter challenges or have questions in applying the bundling analysis to the example?

NOTE: If your own state’s approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

g) Differences in the approach to bundling used by your state, or
h) Differences between the assumptions here and your own state’s tax laws.

Example 5

Facts:

- Seller I acquires data, performs research, and creates a database of information which is organized and used by Seller I.
- Seller I publishes reports on the research.
- Seller I sells the reports for $100 each in printed or downloadable form; Seller I has 10 such reports. The reports are copyrighted to the Seller I.
- Seller I also contracts with individuals who fall into two categories:
  - Data Customers
    - For $600, individuals may obtain five of the published reports.
    - A Data Customer may submit their personal data to Seller I. If they do, Seller I will analyze the data and provide the Data Customer with an updated report based on the Data Customer's data and which the Data Customer may download or print. If the Data Customer submits their personal data, they will receive a $200 refund.
    - Seller I updates the Data Customer's report over time as Seller I acquires additional data. The updated report is provided to the Data Customer free of charge.
  - Access Customers
    - For a $2,000 subscription fee (subject to annual renewal for $200 per year), Access Customers obtain access to all published reports as well as to the data and information that Seller I has acquired.
    - The data and information are made available through Seller I's App. Seller I's App provides access to the reports and other digital tools like log-in, FAQs, visuals highlighting the data, and sorting of reports.
- Customer J is a Data Customer and provides its personal data. Customer J pays $600 and then receives a $200 refund.
- Customer K is an Access Customer.

Assumptions:

- The state generally taxes tangible personal property and includes prewritten software in its definition of tangible personal property.
- The state taxes both physical and digital reports.
- The detailed analysis obtained by Data Customers is not a "digital book."
- The state does not tax services and would include in the definition of service both the analysis of individual data sold to Data Customers as well as the subscription for access to the data provided to Data Customers.

Questions:

a) Sales of the $100 reports:

   i) Is the transaction a bundled transaction? If so, what products are contained in the bundle?

b) Customer J:

   i) Is the transaction a bundled transaction? If so, what products are contained in the bundle?

   ii) May Seller I report as the taxable price the amount ordinarily charged ($600) for the published reports provided?

   iii) What if Customer J chooses to submit their own personal data to obtain the analysis of their data and the updated report(s)?

   iv) May Seller I deduct any amount from the price charged for the detailed report provided to Customer J?

c) Customer K:

   i) Is the transaction a bundled transaction? If so, what products are contained in the bundle?

   ii) Assuming Customer K purchases a one-year subscription, may Seller I report as the taxable price the amount ordinarily charged ($1000) for the published reports provided?

   iii) What if Customer K does not access all of the published reports?

   iv) What if Customer K renews the subscription for an additional year—is any part of the renewal transaction a bundled transaction?

d) Does this example present an exception to the Streamlined definition of a bundled transaction?

NOTE: If your own state's approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

i) Differences in the approach to bundling used by your state, or
j) Differences between the assumptions here and your own state's tax laws.

Example 6

Facts:

- Seller L provides a software as a service platform to assist administrators in managing school applications.
- The software as a service platform is packaged with the following to make up the basic package:
  - (1) a platform service for document processing (for applicants' applications), (2) data hosting (for applicants' information), (3) payment processing (for applicants to pay), and (4) administrative tools (for administrators to view, search, and retrieve applicants' data).
  - This platform is mandatory as part of the basic package.
  - The advertised price for the basic package is $4,000. The seller's invoices list prices for items 1- 3 but items 1- 3 cannot be purchased alone.
- Seller L also provides a platform service that enables purchasers to compile scores and comments regarding applications into a single location and routes materials to the appropriate department. The advertised price of this platform is $2,000. The package is optional and can be purchased separately from the basic package.
- Seller L contends that each separately priced item is a separate product.
- Purchaser M purchases the basic package and the optional package.

Assumptions:

- The state generally taxes software as a service.
- The state does not tax payment processing or data hosting.

Questions:

a) Is the transaction a bundled transaction?
   i) Is there one or more "distinct and identifiable" products? If so, what are they?
   ii) Is there one nonitemized price? If so, what is the price?
   iii) Does the sales price vary or is it separately negotiable based on purchaser selection? Is so, how does that impact the result?

b) Does this example present an exception to the Streamlined definition of a bundled transaction?

c) Did you encounter challenges or have questions in applying the bundling analysis to the example?

NOTE: If your own state's approach to bundling is different from the Streamlined approach, we would also be interested in knowing whether you think the result would differ and whether this difference would be due to:

k) Differences in the approach to bundling used by your state, or
l) Differences between the assumptions here and your own state's tax laws.