

MEMORANDUM

TO: Digital Products Bundling work group

FROM: Mia Strong, Work Group Vice-chair

RE: Summary of bundling study group exercise and discussion

DATE: April 3, 2025

Background

The bundling study group was formed by the Digital Products Work group to assess the Streamlined bundling rules. To do this, the study group applied the Streamlined Sales and Use Tax Agreement (Streamlined) bundling rules to six examples involving digital products. The goal was to determine if there were situations or details where the nature of digital products created issues for the Streamlined bundling rules.¹ A summary of the Streamlined bundling rules can be found [here](#). The examples were created by MTC staff and work group chair Tim Jennrich and were based mostly on real world examples. The examples can be found [here](#).

The work group decided to include state staff and Streamlined staff in the bundling study group. The MTC staff solicited volunteers and received responses from 12 states, including the District of Columbia. Work group vice chair, Mia Strong, was selected as chair of the bundling study group.

Activities

The bundling study group held an initial session on December 9, 2024. The group decided to hold at least two further sessions. The group agreed to develop answers to the first three bundling examples and discuss those at the next session.

The group held their next session on January 6, 2025, where the group discussed the results from the first three examples. Results were received from Colorado, the District of Columbia, Iowa, Kentucky, Louisiana, Nebraska, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin.

The group held its third session on January 27, 2025. At this session the group discussed the results from the final three examples and the study group's report to the work group. Results were received from the same group of states as for the first three examples.

The group held its fourth session on March 21, 2025. At this session the group discussed this report and agreed to finalize the report following circulation of an additional draft.

General Observations

Initial Issues

The group acknowledged that the Streamlined bundling rules work reasonably well. The group thinks they are worth considering for non-Streamlined states. The recommendations below are

¹ The Streamlined bundling rules originally date to 2006, a helpful guide to those rules can be found [here](#).

proposed as amendments to a state's existing Streamlined bundling rules or as potential additions to those rules if they are considered for adoption by non-Streamlined states.

The group discussed the intent of the bundling rules to a limited extent. The group identified that for a given transaction, there are many ways out of the bundling rules, but only a narrow path to remain under the bundling rules. The group was told that the Streamlined bundling rules were meant to be narrow, providing both an objective test for, and a set of subjective exclusions from, the bundling rules. Due to this, a given transaction escaping treatment under the bundling rules should not be surprising and is not a bad thing.

Related to this, the group discussed the basic mechanics of the Streamlined bundling rules and that, under the Streamlined Agreement, the determination of taxability is separate from the bundling determination. The taxability of a bundled transaction is up to each state. The point that the bundling rules are meant to be narrowly applicable was made and accepted.

Digital products in General

The group questioned the best way to analyze digital products in general given that many have no traditional, or analog, equivalent. One member noted that digital products are difficult to fit into the existing categories that are so important for sales tax. This comment reveals that the tax base cannot be totally separated from the bundling question. Taxpayers and administrators want to know what is taxable and what is not, not just whether something is a bundle. As one study group member put it, the ultimate worry is about taxability, not about bundling. Bundling analysis for its own sake is not the goal.

Another issue specific to digital products was the splitting apart of products that should be treated as a single item. The group agreed this is seen with traditional physical items but is seen to a greater extent with digital products. One member shared the example of a furniture manufacturer attempting to separate blueprints, intellectual property, and other components of their furniture. They noted that this attempt was easily rejected but that the analysis is more difficult with digital products.

Under the Streamlined rules, a bundled transaction consists of two or more distinct and identifiable products. Members agreed that identifying distinct and identifiable products is more difficult with digital products than with physical products. Some reasons given were that staff know less about digital products than traditional products and digital products are often complicated, unfamiliar, and exotic. Overall, the group agreed that under the bundling rules, sellers have great latitude in asserting whether there are distinct and identifiable products involved.

Members noted that if a transaction is not subject to the bundling rules, there is not much to hold a digital product transaction together. If a transaction is not a bundle, then it is relatively easy to whittle down the tax base. One example raised was a streaming company potentially claiming it provides not just access to the streamed videos, but the algorithm, the sorting service, the billing service, and other things.

Members again noted this is less of an issue with traditional products, with some noting the familiar "smell test." Most staff are familiar with traditional physical products and have an intuitive understanding of them. This is not true for digital products.

Issues with Payment of Use Tax

Various members observed that the Streamlined rules are seller focused. This is helpful in situations where the seller is collecting and remitting the tax. However, when the purchaser is responsible for paying use tax, the seller-focused nature of the rules might pose difficulties.

Specifically, the documentation rules are focused on the seller's records, and it will be difficult for a purchaser to know what the seller has in its records. For example, whether the seller has a catalog that lists the prices separately and that those prices add up to the total price the seller is charging. This information is crucial to the one non-itemized price element but will be difficult for a purchaser to obtain.

The seller may cooperate with the purchaser, particularly for infrequent and large purchases, to help the purchaser determine if they will owe use tax. In other situations, this may not be practicable.

One non-Streamlined state member was asked what their state would expect the purchaser to look to. The response was that the communication between the seller and purchaser would be relevant, as would the invoice or contract.

Specific Observations and Findings

Distinct and Identifiable

Under the Streamlined rules, the sale of two or more distinct and identifiable products is treated as a bundled transaction if no exception or exclusion applies. The definition of "distinct and identifiable" is posed in the negative. For example, distinct and identifiable products do not include packaging, wrapping, or other materials that accompany the retail sale but are incidental or immaterial to the retail sale, nor do distinct and identifiable products include products provided free of charge with a required purchase.

The group again observed that under the Streamlined bundling rules, particularly for digital products, sellers may have broad ability to assert whether one or more distinct and identifiable digital products is offered. This creates the opportunity to split apart what should be treated as one product to achieve a tax result.

The group recommends mitigating this issue. One option is to clarify that state law can determine when digital components are a single product. Defining a single product as one including component X, Y, and Z would prevent that product from being broken down into the components X, Y, and Z. Another option is to develop a test to determine if there is a single product. For more on this proposal, see the "A Pre-bundling Analysis?" section below.

One non-itemized price

Under the Streamlined rules, a purported bundle must be sold for one non-itemized price to be a bundle.

The members consistently raised issues with the one non-itemized price element, specifically, the ‘price list’ exception. The Streamlined language reads “separately identified by product on binding sales documents or other sales-related documents such as invoices, bills of sale, receipts, contracts, service agreements, and price lists made available to the purchaser in either paper or electronic form.”

One member noted that the price list is a common way taxpayers try to separate or break up digital products. Members observed it is not clear where the separate prices must be listed for this exception to apply, nor is it clear whether the items must be available at the listed prices for the exception to apply. Some members, specifically from non-Streamlined states, wondered how this is working in practice.

Members noted this is a more pressing problem with digital products than with traditional products. A taxpayer could include a document of terms and conditions with each transaction that includes a price list while keeping it inconspicuous, where that may be less practicable with a traditional transaction.

Other members stated that if a package is offered for a single price, but individual prices are provided for various components of the package, then the package is not offered for one non-itemized price and therefore there is no bundle. They stated this was true even if the individually priced items are not available separately, noting this is a result of the bundling rules being purposefully narrow.

Due to these varying opinions, the study group recommends any state considering this approach add detail to the one non-itemized price requirement and its exceptions. Several options were offered. One was to state that the seller must offer the items for sale at the separate listed prices for the ‘price list’ exception to apply. However, some members reiterated the seller-focused nature of the Streamlined bundling rules, see *Issues with Payment of Use Tax* above, and that this makes it impractical for the purchaser to know this information. Another option offered was use of a rebuttable presumption to shift the burden to the seller. A third option was adoption of an anti-abuse rule asking whether the behavior appears to be tax avoidance.

Sales Price Varies

Under the Streamlined rules, a purported bundle is not a bundle if the price varies, or is negotiable, based on the selection by the purchaser of the products included in the transaction.

There was some variance on the understanding of whether the sales price varied. One example in the exercise involved a transaction where an existing customer could submit personal data to receive updated reports and a “\$200 refund.” There was no consensus on the treatment of this, with some seeing a simple discount and some seeing a separate transaction. Those viewing it as a separate transaction cued on the seller’s desire for more data for its own purposes.² If a state is

² Others noted the corollary to this, which is the situation where the updated reports are free and the customer’s personal data is provided without the customer even being cognizant of it. This is another area where digital products may stretch the bundling rules. The issue is whether the transaction is limited to the items the customer paid a fee for or includes each item the customer receives. The price may be reflective of the cost of some products or components, but the more engaged the customer is, the more data the customer produces, and therefore that customer may receive much more

considering adoption of this exception, an example or additional language clarifying this situation would be helpful.

De Minimis Exclusion

The de minimis exclusion excludes a transaction from the Streamlined bundling rules if the price of the taxable component is 10% or less of the total price.

The de minimis exclusion can be interpreted in light of the narrow intent of the Streamlined bundling rules, noted earlier. The bundling rules were meant to be narrow, and so the de minimis exclusion was meant to exclude transactions where treating an entire package as a bundle would be unfair.

The treatment of Software as a Service (SaaS) packaged with an application was raised as an example of the role of the de minimis exclusion. The question is typically whether the application is material or *de minimis*. One example provided was tax preparation software and associated application compared to the traditional prepared physical tax return. The paper involved in the traditional return is only for transmittal; the information reaching the taxing agency is what is important. For some, the application associated with the tax preparation software has little intrinsic value and is incidental to obtaining access to the software, data, or other material that effectuates communication with the taxing agency. This issue came up during discussion of the true object exclusion, see below.

The group also identified the valuation component of the de minimis exclusion as problematic, particularly when the transaction involves digital products. The group observed it is often unclear how to value a component of a purported bundle. One member raised the inclusion of a “library fee” in one of the examples, inquiring how a fee like that would be valued when the fee is spread over many customers. Other members noted that pieces of a purported bundle are hard to value if they are not sold separately, which is often the case with packages containing digital products, or if they are self-produced.

Regarding whether the ten percent threshold of the de minimis rule is appropriate, the group identified the issue but did not discuss it. Critical to this point is the philosophy behind the de minimis rule. Should the threshold be high enough so that when it is exceeded, treating the entire transaction as a bundle seems fair? Alternatively, should the threshold be low enough so that only transactions with the thinnest amounts of taxable products escape treatment as a bundle? This determination is beyond the scope of the work group’s assignment.

True object exclusion

There were some challenges with application of the true object exclusion. There are two iterations of the true object exclusion. Under the one involving tangible personal property and services, the tangible personal property must be essential to the use of the service, not the other way around. Additionally, the tangible personal property must be offered exclusively in connection with the

due to the value of the customer’s data. Whether the ‘much more’ is a distinct and identifiable product is the easiest issue to spot here. The study group did not discuss this in depth but shares it for potential consideration.

service, and the true object must be the service. There was some confusion over the operation of this exclusion.

Additionally, the application of the true object exclusion to a transaction involving more than two services is unclear. Clarification of the applicability to transactions involving more than two services would be helpful.

An issue specifically created by digital products is the terminology used in the true object exclusion. Whether an item is “TPP, item, property, or good,” on the one hand, or a “service,” on the other, determines which version of the true object exclusion applies. However, the references are not to digital products or digital services, but only to “TPP, item, property, or good” and to “services.” Therefore, the application to digital products is unclear.

The group recommends that any state considering this type of exclusion consider clarifying its application to transactions involving more than two services and to transactions involving digital products.

A Pre-bundling Analysis?

While discussing the true object exclusion, the concept of breaking up digital products arose again. This time, the issue was the actual splitting up of digital products rather than use of a price list. The suggestion made was to impose a threshold question of whether a transaction is composed of ‘integral’ components. If the answer is yes, then the transaction is one product.

One member described their belief that this is already happening unofficially. The member stated that under the current analysis a threshold, upfront, subjective test is performed to determine if a transaction is a single product or not. They believe this analysis is necessary and appropriate but should be made official and fully described.

The group recommends any state considering the Streamlined bundling rules consider adding an upfront inquiry into whether a transaction is one product or a set of distinct and identifiable products.³ The inquiry would serve as a type of anti-abuse rule to bolster the bundling rules as applied to digital products. However, if the legislature has defined a single product in a way that includes multiple components, then this should be treated as one product, regardless of the outcome of the proposed threshold inquiry.

Recommendations

- Consider expanding the language used in the exclusions to bundling, including the true object exclusion, to apply to digital products.
- Consider clarifying the applicability of the service-to-service true object exclusion to transactions involving more than two services. Consider adding a third iteration of the true object exclusion for transactions involving digital products.
- Consider clarifying the de minimis exclusion, including adding detail on valuation methods.

³ The related question is who determines whether something is a single product or distinct and identifiable products.

- Consider adding detail to the one non-itemized price element and its exceptions, particularly the role of a price list and the labeling and pricing of components.
- Consider developing a threshold inquiry to determine whether a transaction is one product or a set of distinct and identifiable products.