



Taxation of Digital Products Uniformity Project

Draft White Paper Section on Bundling

April 28, 2026

1. Scope

The Digital Products Work Group was formed to draft a white paper on the issues states should consider when including digital products¹ in their sales tax base.² At their March 7, 2024 meeting, the work group voted to study bundling issues.³

Digital products may pose new challenges to states' bundling rules compared to bundles that include traditional goods or services. The primary question addressed in this section of the white paper is:

Does the inclusion of digital products in a sales and use tax base present unique issues with respect to bundling compared to traditional property and services?

To address this question, this section of the white paper (1) describes the primary approaches to bundling and their relation to digital products, (2) highlights the positives and negatives of those approaches, and (3) presents findings.

2. What is bundling?

The term “bundling” in sales and use tax systems refers to situations where multiple products with different tax treatments are sold for a single price (i.e., bundled). Bundling rules allow states and businesses to assign consistent taxability rules to transactions that include both taxable and nontaxable products.

Bundling rules serve two important purposes. First, they provide certainty to retailers, so they know when and how much tax to collect at the point of sale. Second, they promote

¹ For purposes of this MTC uniformity project, the term “digital product” means both goods and services.

² Visit the MTC project page at <https://www.mtc.gov/uniformity/sales-tax-on-digital-products/>.

³ Notes from that work group meeting are available here: <https://www.mtc.gov/wp-content/uploads/2024/04/Digital-Work-Group-Notes-03-7-24.pdf>

simplification and consistency in tax administration. Bundling rules only apply when there are separable or distinct and identifiable products involved.⁴

Bundling rules may result in otherwise nontaxable products that are part of a bundle being subject to tax, leading to risks of inaccurate sales and use tax collection for sellers, fairness concerns, and confusion on the part of purchasers as to how sales and use tax is calculated.

Sometimes businesses are allowed to unbundle packages of separable taxable and nontaxable products and collect tax only on the taxable portions. This is typically based on some objective criteria such as customer invoices or the seller's books and records. Unbundling generally allows each product to be treated as if it were sold separately.

3. Staff research into, and study group exercise on, Streamlined bundling rules

The Streamlined Sales Tax Governing Board, Inc. (Streamlined) has developed a comprehensive set of rules for defining a bundled transaction, how products can be unbundled, and transactions excluded from bundling.⁵

The Digital Products Work Group formed a study group to assess the application of the Streamlined bundling rules. The study group applied those rules to six examples involving digital products. The study group determined the Streamlined rules worked well but identified various problem areas and offered recommendations for clarification and improvement. The full report from the exercise can be found [here](#). In addition, MTC staff researched and summarized the Streamlined bundling rules. The results of this research, along with the study group's recommendations, are provided below.

A. Streamlined Basics and Study Group Findings

As mentioned above, the Streamlined Sales Tax Governing Board, Inc. has developed a comprehensive set of rules governing “bundled transactions.”⁶

Under the Streamlined Agreement, a “bundled transaction” has three elements: (1) two or more distinct and identifiable products, (2) sold for one non-itemized price, and (3) a sales

⁴ For treatment of inseparably mixed transactions, see section 4.C. of this white paper.

⁵ See [Streamlined Agreement section 330](#) and accompanying definitions in [Appendix C, Part 1](#) of the Streamlined Agreement, and the [Streamlined Rules section 330](#).

⁶ See [Streamlined Agreement section 330](#) and accompanying definitions in [Appendix C, Part 1](#) of the Streamlined Agreement, and the [Streamlined Rules section 330](#).

price that is not variable or negotiable, based on selections by the purchaser.⁷ Each of these is discussed below along with the study group’s recommendations.

Distinct and identifiable products

Under the Streamlined agreement there must be two or more “distinct and identifiable” products. “Product,” as defined in the Streamlined Agreement, is broad and captures goods, services, and other things that can be sold.

The term “distinct and identifiable” is defined only in the negative. The definition excludes packaging materials, bags, bottles, and other similar items. The definition also excludes things “provided free of charge with the required purchase of another product” as well as items included in the purchase price.⁸

During one MTC work group meeting a participant stated it thus: “if you can’t unbundle it, it isn’t a bundle.” In other words, you need distinct and identifiable elements, i.e., unbundlable elements, to have a bundle. However, this does not go both ways. Bags and packaging materials can be unbundled, but are deemed not to be distinct and identifiable items.

A real-world example: in the case of an online streaming product that could also be downloaded, the Utah State Tax Commission determined the online streaming option and the content download option were distinct and identifiable products.⁹

Study group findings:

Study group members agreed that identifying distinct and identifiable products is more difficult with digital products than with traditional products. Relatedly, the study group agreed that attempts to split a product apart into its components, when it should be treated as a single item, are more common with digital products than with traditional products.¹⁰ The study group recommended mitigating this issue by either defining specific products to include components X, Y, and Z, or by introducing a threshold test to determine if the product is a single product. For more on the latter, see the Proposed New Framework in section 6.C below.

Sold for one non-itemized price

⁷ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions.

⁸ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions.

⁹ Utah State Tax Comm. Dec., App. No. 22-1274 (May 1, 2025).

¹⁰ The stakeholders interviewed shared similar sentiments, see section 7.A summarizing stakeholder interviews.

“One non-itemized price” is another element of a bundled transaction. The term is defined only in the negative. One non-itemized price excludes a price that is separately identified by product on binding sales documentation or other sales-related documentation that is made available to the customer. Qualifying documentation includes invoices, bills of sale, contracts, service or lease agreements, rate cards, and other similar documentation.¹¹

The reasoning behind this element is that if the retailer makes individual product prices available, it has an objective method of separating the products, establishing their appropriate selling price, and collecting and paying tax according to the appropriate tax classification. The retailer controls itemization.

In Rhode Island, the Department of Revenue considered a subscription giving customers unconditional access to a variety of products, including expedited shipping, streaming video, electronic books, streaming music, photo storage, and access to video games. The Department determined the subscription was a bundle because it bundled goods, services, and other benefits that were distinct and identifiable together for one non-itemized price.¹²

Study group findings:

Study group members noted several issues with this element of the Streamlined rules. These issues included the possible use of the price list to inappropriately split a digital product apart into its components; lack of clarity on where the separate prices must be listed; and whether the separately priced items had to be actually available at the listed prices. Some members stated that there were clear answers to these. For example, some members stated that merely providing a price list for the components meant the purported bundle was not offered for one non-itemized price, even if the components were not available separately for those prices. Others disagreed.

Due to this inconsistency, the group recommended clarifying this provision and offered three options. One option was to honor the price list only if the seller offers the items for sale at the separate listed prices. Another option was to introduce a rebuttable presumption to shift the burden to the seller, so the seller would be required to provide more information. Another option was use of an anti-abuse rule based on whether the behavior appears to be tax avoidance.

Variable sales price

Another element of the Streamlined bundling rules is whether the sales price is variable or negotiable based on the purchaser’s selections. The Streamlined rules provide that a

¹¹ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions.

¹² Rhode Island Dec. Rul. Req. No. 23017-01 (March 31, 2017).

transaction is not a bundled transaction if, by negotiation or otherwise, the sales price varies with the purchaser's selection of the distinct and identifiable products being sold.¹³ A retail sale shall not be considered made for "one non-itemized price" if the purchaser has the option of declining to purchase any of the products being sold and, as a result of the purchaser's selection of products, the sales price varies or a different price is negotiated.¹⁴

For example, in a situation where a vendor offered "mix and match" packages where the customer exercised choice over the packages and the product's discounting depended on those choices, the Department of Revenue determined the sales price varied based on the purchaser's selections and the transaction was not a bundle.¹⁵

Study group findings:

The study group encountered some variation in opinion on this element. One of the examples addressed by the study group involved a transaction where a customer could submit additional personal data to receive updates and a partial refund. The study group members did not reach consensus on the treatment of this. Some members viewed this as a discount while others considered it a separate transaction. The study group members recommended additional language or an example to clarify the treatment of this situation.

B. Streamlined Exclusions and Study Group Findings

There are several exclusions from the Streamlined rules. If the criteria of one of the exclusions is met, a transaction that would otherwise be considered a bundled transaction is deemed not to be a bundled transaction.

i. True object exclusions

The Streamlined Agreement contains two true object exclusions:

- If the taxable tangible personal property (TPP) is essential to the use of the exempt service, *and* is provided only in connection with the exempt service, *and* the true object of the entire transaction is the exempt service component, then the transaction is excluded from the Streamlined bundling rule.¹⁶

¹³ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions.

¹⁴ Streamlined Rules and Procedures, Rule 330.1.B.2.

¹⁵ Georgia Letter Ruling 2019-10 (Nov. 2019) (Taxpayer developed and sold consumer electronics, computer software, online services, and related support, and some third-party digital content and applications. Taxpayer offered preselected packages as well as custom packages. Custom packages allowed purchasers to choose what was included in the package and taxpayer offered discounts to encourage custom packages. There were no individual prices shown to the customer. The Department ruled the preselected packages were bundles, while the custom packages were not. The custom packages were not bundles because the sales price varied based on the purchaser's choices.)

¹⁶ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(1).

- If there is a sale of two services where the first service is essential to the use or receipt of the second service *and* the first service is provided exclusively in connection with the second service, *and* the true object of the transaction is the second service, then the transaction is excluded from the Streamlined bundling rule.¹⁷

Although this is called the true object exclusion, the true object of the entire transaction is only one of three elements of this exclusion. The other two elements are (1) that the TPP¹⁸ is essential to the service and (2) that the TPP is provided exclusively in connection with the service. This means that even if the true object of the transaction is an exempt service, the transaction might still fall under the Streamlined bundling rule. For example, if the true object of the transaction is an exempt service, but the TPP is sometimes provided independently of the service.

The exclusions seem to address accuracy and fairness concerns. While there may be more than one product sold in the transaction, from the taxpayer's perspective the customer is only interested in purchasing the product that is the true object of the transaction and the transaction should be taxed accordingly. These two tests are subjective and defined on a state-by-state basis, and it is presumed, perhaps arbitrarily, that there cannot be more than one true object.

Study group findings:

The study group members experienced confusion about how the true object exclusions work. Specifically, the study group members noted that the application to a transaction involving more than two services is unclear and that the terms of the exclusion do not specifically refer to digital products. The study group recommended clarifying these points.

ii. De minimis exclusion

“De minimis” generally means lacking significance, lacking importance, or being so minor as to merit disregard. The de minimis exclusion excludes from the Streamlined bundling rule a transaction that includes both taxable and nontaxable products if the price of the taxable product is 10 percent or less of the total price. Either purchase price or sales price can be used.¹⁹

¹⁷ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(2).

¹⁸ Or the first service, in the case of a transaction involving two services.

¹⁹ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(3).

This exclusion also seems to address accuracy and fairness concerns. If a state imposed sales tax on 100 percent of the price of a bundle in cases where the bundle consists of only of a de minimis amount of taxable items, that might be viewed as unfair or excessive.

Study group findings:

The study group members agreed that valuing the taxable portion of a bundle was an issue with the de minimis exclusion. Questions include the appropriate methodology to be used to value self-produced components and components not sold separately as well as how to value components when the total fee is spread across many users. The study group recommended adding detail on the appropriate valuation methodology.

iii. Food, drug, and medical equipment exclusion

This exclusion is a version of the de minimis rule. It excludes from the Streamlined bundling rule a transaction that involves food, drugs, or certain medical equipment or devices if the purchase price or sales price of the taxable portion is 50 percent or less of the total purchase price or sales price.²⁰

The rule reflects a policy preference for specific consumables and industries. The rule provides a more generous de minimis exclusion to transactions involving food, drugs, and certain medical equipment. As a result, transactions involving these products are less likely to be treated as a bundle, and therefore less likely to be taxed on their entire value.

Study group findings:

The study group did not study this exclusion in detail. However, this exclusion will likely create valuation issues similar to the general de minimis exclusion.

4. Results of staff research into other state approaches

A. Colorado's take on Bundling

Colorado imposes tax on the entire price of a bundled transaction.²¹ Colorado also provides that services that are otherwise excluded from sales tax are taxable if provided as part of a “mixed transaction” that includes the sale of TPP or taxable services.²² Colorado law uses

²⁰ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(4).

²¹ Colo. Prv. Ltr. Rul. No. 10-001; see also, Colo. Prv. Ltr. Rul. No. 12-006 (rescinded).

²² Colo. Prv. Ltr. Rul. No. 23-004; see also, 1-CCR 201-4 § 39-26-102(12); -102(7)(a); *A.D. Store Co., Inc. v. Exec. Dir.*, 19 P.3d 680, 683-684 (Colo. 2001).

the term “separable” for bundling analysis. This concept is from the *A.D. Store* case.²³ This is a similar concept to “distinct and identifiable” under Streamlined. Colorado Special Rule 18²⁴ states that transportation charges are not taxable if they are both separable and stated separately on a written invoice. In general, the Department requires the nontaxable items to be separately stated to the customer to avoid tax if those items are separable.

Colorado Private Letter Ruling 23-004²⁵ addresses the concept of separability. The ruling describes an item as separable if its nature remains the same whether it is contracted for as a part of the mixed transaction, or at a later time, and purchase of the item at a later time is possible.²⁶ The ruling addressed travel experience packages that were sold for a fixed price. The ruling turned on the fact that the seller did not market or sell the parts of the package separately. The Department determined this meant the elements were not separable. Because the items were not separable, the true object test applied rather than the bundling treatment. The Department then determined the true object of the transaction was the travel experience.

B. Other State Treatment

Bundling involves distinct and identifiable products, sometimes referred to as separable products. However, some state rules apply in cases where the components are not separable, while others do not distinguish between separable and inseparable components.²⁷

i. The role of sales price

Many states address the issue raised by the mixing of taxable and nontaxable components by relying on the definition of “sales price” or an equivalent term.

Florida

A straightforward example of this is Florida’s definition of “sales price” as the total amount paid, including any services that are part of the sale.²⁸ Florida’s law then excludes from tax

²³ *A.D. Store Co., Inc. v. Exec. Dir.*, 19 P.3d 680 (Colo. 2001) (In *A.D. Store*, the Colorado Supreme Court held that if the price of the taxable TPP can be meaningfully separated from the price of the nontaxable service, then the service was not taxable. The court then determined that alteration services performed on clothing were separable from the clothing sold and altered.)

²⁴ 1-CCR 201-5, Special Rule 18.

²⁵ Colo. Prv. Ltr. Rul. No. 23-004.

²⁶ Citing to *A.D. Store*, 19 P.3d at 684.

²⁷ Acknowledging the risk of conflating transactions that have separable or distinct and identifiable components (and are thus treated under bundling rules) with those that do not, we state here that if a state is silent on the question of separable and distinct and identifiable components, then the non-bundling rules below might apply even though the transaction has separable or distinct and identifiable components as defined by the law of a state that actually addresses the question.

²⁸ Fla. Stat. § 212.02(16).

professional or personal services transactions involving taxable sales that are inconsequential and not separately stated.²⁹

Taken together, these two provisions from Florida’s law create a rule under which any transaction that includes taxable TPP is taxable on the entire amount charged, regardless of the inclusion of nontaxable services, unless those services are both inconsequential and separately stated. Other states rely on similar language.³⁰

Idaho

Idaho has adopted a regulation under their statutory definitions of “retail sale,” “sale,” and “sales price.”³¹ The rule provides that when a sale of TPP includes incidental services, sales tax applies to the entire amount charged. The rule further provides that if a service transaction includes incidental TPP, the transaction is not taxable. The rule provides that the test is whether the service involved is consequential or inconsequential.

ii. Rules not based on sales price

Arizona

In Arizona, TPP and services that are transferred together for a single, non-segregated price are taxable on the entire amount charged, if the TPP is a consequential element of the transaction.³² Arizona also provides that when the TPP is an inconsequential element of rendering a nontaxable service, then the entire amount is not taxed.³³ To qualify as an “inconsequential element:” (1) the amount paid by the service provider for the TPP must be less than 15 percent of the amount charged by the service provider for their service; (2) the TPP must not be in a form that is subject to retail sale; and (3) there is no separately stated charge for the TPP.³⁴

California – subject matter specific rules

For newspapers and periodicals: California regulations define the term “mixed newspaper subscription”³⁵ and establish a presumption that 47 percent of the charge for a mixed

²⁹ Fla. Stat. § 212.08(7)(v)(1) (exemption statute).

³⁰ Conn. Gen. Stat. § 12-412(11) (exemption statute); Ga. Code Ann. § 48-8-3(22) (exemption statute); Md. Code Ann. Tax-Gen. § 11-219(a) (exemption statute); Mass. Gen. Laws ch. 64H, § 1 (definition of “sale at retail” or “retail sale”); Ohio Rev. Code Ann. § 5739.01(B)(12) & (13) (definition of “sale” and “selling”); Va. Code Ann. § 58.1-609.5(1) (exemption statute).

³¹ Id. Regs. § 35.01.02.011.01.

³² A.R.S. § 42-5061(F); Ariz. Admin. Code § 15-5-105.

³³ A.R.S. § 42-5061(A)(1); Ariz. Admin. Code § 15-5-104(B).

³⁴ Ariz. Admin. Code § 15-5-104(C); *but see* Val-Pak East Valley, Inc. v. Ariz. Dep’t of Rev., 272 P.3d 1055 (Ariz. Ct. App. 2012) (applying the true object test to direct mail advertising rather than the bundling rule).

³⁵ Cal. Code Regs. tit. 18, §1590(a)(5).

newspaper subscription is taxable and 53 percent is non-taxable.³⁶ The percentages are based on a study the newspaper industry provided. It also provides a formula that publishers can use to rebut the presumption and establish a larger nontaxable percentage.³⁷

*For technology transfer agreements*³⁸ (TTAs): California law establishes a formula for determining the taxable portion of a transaction involving the transfer of TPP and patent or copyright interests.³⁹

The statute provides that gross receipts do not include the amount charged for intangible personal property transferred with TPP in a TTA if the TTA separately states a reasonable price for the TPP. If the price for the TPP is not separately stated and the TPP, or like TPP, has been offered for sale or lease to third parties, then the price for third parties is used to price the TPP. The remainder of the amount charged is attributable to the intangible property transferred.⁴⁰

If the TTA does not separately state the price for the TPP and the TPP, or like TPP, has not been offered for sale or lease to third parties, then the TPP is priced equal to 200 percent of the cost of materials and labor used to produce the TPP, with the remaining amount charged being attributable to the intangible property transferred.⁴¹

C. True Object Test and Mixed Transactions

The true object test⁴² is a subjective test used to determine whether a transaction with inseparable elements is treated according to its taxable or its nontaxable components.⁴³ The fact that the true object test is used in categorizing inseparable transactions highlights concerns that it might not be the best to use in conjunction with bundling. Typically, the

³⁶ Cal. Code Regs. tit. 18, §1590(b)(3)(B).

³⁷ Cal. Code Regs. tit. 18, §1590(b)(3)(B).

³⁸ Cal. Rev. & Tax. Code §6012(c)(10)(D) defines “technology transfer agreement” as any agreement under which a person who holds a patent or copyright interest assigns or licenses to another person the right to make and sell a product or to use a process that is subject to the patent or copyright interest.

³⁹ Cal. Rev. & Tax. Code §6012(c)(10).

⁴⁰ Cal. Rev. & Tax. Code §6012(c)(10)(B).

⁴¹ Cal. Rev. & Tax. Code §6012(c)(10)(C).

⁴² In this whitepaper we use the term “true object test” to mean any similar terminology used by states, such as “essence of the transaction test.”

⁴³ Hellerstein, Hellerstein & Appleby, *State Taxation*, § 12.08[1] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2023) (online version accessed on Checkpoint (www.checkpoint.riag.com) July 11, 2024).

distinction to be addressed under the test is that between taxable TPP and nontaxable services or intangibles.⁴⁴

Tennessee has had extensive development in their true object test case law, so their law is useful to provide the basics. Examples of transactions subject to the true object test in Tennessee include: a painting an artist was commissioned to make, discount cards, and for an example with two services, a staffing company that provides workers, which is a nontaxable service, to a company that repairs TPP, which is a taxable service.⁴⁵

In Tennessee, there are three categories of results:⁴⁶

1: A transaction with a taxable true object means any crucial, essential, necessary, consequential, or integral elements of the transaction are taxable. This is not an all or nothing result. Even with a taxable true object, only the crucial, essential, necessary, consequential, or integral elements are taxable. Other components may be subject to different treatment, even though the true object of the transaction is taxable.⁴⁷

2: A transaction with any taxable component that is crucial, essential, necessary, consequential, or integral means that transaction is taxable, even if the true object of the transaction is not independently taxable.

3: A transaction with a nontaxable true object and taxable items that are merely incidental to the true object is not taxable.

⁴⁴ Hellerstein, Hellerstein & Appleby, *State Taxation*, § 12.08[1]; however, in New York, the “primary function” test is reserved for transactions involving taxable and nontaxable services and is not appropriate for transactions involving TPP and services, *In the Matter of the Petition of Facility Source, LLC*, DTA Nos. 829500 & 829501 (N.Y. Tax Appeals Tribunal 2025).

⁴⁵ Tenn. Ltr. Rul. 14-10.

⁴⁶ Tenn. Ltr. Rul. 14-10.

⁴⁷ This demonstrates the intersection between bundling and the true object test. This rule provides that only the crucial, essential, necessary, or consequential elements follow the tax treatment of the true object. Essentially, this is saying that if it is not crucial, essential, necessary, or consequential, then it is “distinct and identifiable,” or, to use non-Streamlined language, “separable,” and therefore its taxation should not be determined by the true object test.

Note there are variants to the true object test⁴⁸ and additional factors relevant to the true object test⁴⁹ that are beyond the scope of this white paper.

One situation where the true object test is not applicable is that of “mixed transactions.” Mixed transactions are those where the various elements being analyzed are not packaged, bundled, or intertwined enough to be viewed as one, or the elements have too much independence from one another to be viewed as one.

In *Rylander v. San Antonio SMSA L.P.*,⁵⁰ the court considered transactions for network equipment and engineering services to configure the equipment. The equipment and services were priced separately but invoiced together. The court held the equipment and the engineering services were independently desired and independently provided, were readily separable, and neither was “incident” to the other. The result was that the true object test did not apply, and the engineering services and equipment must be analyzed separately for taxability. In *SMSA*, the Texas court cited extensively to *New England Tel. & Tel. Co. v. Clark*,⁵¹ from Rhode Island. In *Clark*, the issue and result were similar.

D. Generalized Bundling Decision Tree⁵²

The decision tree below demonstrates the operation of current state law, both Streamlined and other law, as it applies to treating bundled transactions.

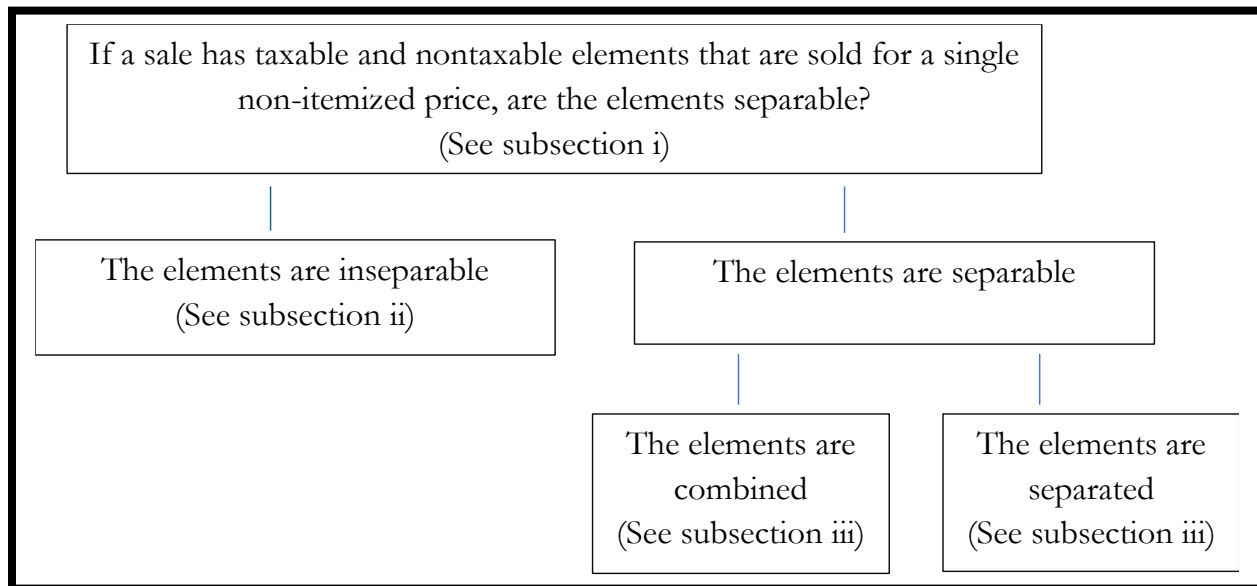
⁴⁸ See, e.g., *City of Boulder v. Leanin’ Tree, Inc.*, 72 P.3d 361 (Colo. 2003) (common understanding test); *Emery Indust., Inc. v. Limbach*, 539 N.E.2d 608 (Ohio 1989) (overriding purpose test); *Hasbro Indus., Inc. v. Norberg*, 487 A.2d 124 (R.I. 1985) (real object test); *Quotron Systems, Inc. v. Comptroller of Treasury*, 411 A.2d 439 (Md. 1980) (predominant purpose test); *Bullock v. Statistical Tabulating Corp.*, 549 S.W.2d 166 (Tex. 1977) (essence of the transaction test); *WTAR Radio-TV Corp. v. Commonwealth*, 234 S.E.2d 245 (1977) (true object test); *Catalina Marketing Sales Corporation v. Department of Treas.*, 678 N.W.2d 619, 626 (Mich. 2004) (incidental to service test).

⁴⁹ *Washington Times-Herald v. District of Columbia*, 213 F.2d 23 (D.C. Cir. 1954) and *Fingerhut Prods. Co. v. Comm’r of Revenue*, 258 N.W.2d 606 (Minn. 1977) (value of TPP versus intangibles); *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn. 1976) and *Bullock v. Statistical Tabulating Corp.*, 549 S.W.2d 166 (Tex. 1977) (whether there was an alternative method of transfer); *Fingerhut Prods. Co. v. Comm’r of Revenue*, 258 N.W.2d 606 (Minn. 1977) and *Williams Lee Scouting Service, Inc. v. Calvert*, 452 S.W.2d 789 (Tex.App. 1970) (the length of time the information provided retains its value); *Dun & Bradstreet, Inc. v. City of New York*, 11 N.E.2d 728 (1937) (constraints on the buyer’s ability to use the property); *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405 (Tenn. 1976) and *Sneary v. Director of Revenue*, 865 S.W.2d 342 (Mo. 1993) (what is eventually done with the TPP); *Columbus Coated Fabrics Div. v. Porterfield*, 285 N.E.2d 50 (Ohio 1972); *Hasbro Indus., Inc. v. Norberg*, 487 A.2d 124 (R.I. 1985) (whether the TPP is the product the purchaser sought).

⁵⁰ *Rylander v. San Antonio SMSA L.P.*, 11 S.W.3d 484 (Tex. App. 2000).

⁵¹ *New England Tel. & Tel. Co. v. Clark*, 624 A.2d 298 (R.I. 1993).

⁵² See below section 6.C for a potential new framework.



i. The question of separability.

As noted above, Streamlined states consider whether the components of a transaction are “distinct and identifiable.”⁵³ Non-Streamlined states may make a similar determination. In Texas, services are separable if they are “distinct and identifiable” and of a type which is commonly provided on a stand-alone basis.⁵⁴ Colorado considers whether an item’s nature remains the same whether it is contracted for as part of the mixed transaction or at a later time, and purchase at a later time is an option.⁵⁵

ii. If the elements are inseparable.

Typically, states apply some variant of the true object test when the elements are inseparable—for example, see Tennessee and Colorado.⁵⁶ In Texas, the essence of the transaction test applies to inseparable tangible and intangible property.⁵⁷ See section 4.C above for more on the true object test. The Streamlined agreement does not specify the tax treatment of elements that are inseparable. Presumably, if the elements are inseparable, they represent only a single product that is not subject to the bundling rules.

⁵³ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions.

⁵⁴ See 34 Tex. Admin. Code § 3.330.

⁵⁵ Col. Priv. Ltr. Rul. 23-004, citing *A.D. Store Co., Inc. v. Exec. Dir.*, 19 P.3d 680 (Colo. 2001).

⁵⁶ Tenn. Ltr. Rul. 14-10 & Col. Priv. Ltr. Rul. 23-004.

⁵⁷ *Bullock v. Statistical Tabulating Corp.*, 549 S.W.2d 166, 169 (Tex. 1977).

iii. If the elements are separable.

A state's definition of "sales price," "purchase price," or similar definition may determine the treatment of certain separable elements that are not allowed to be separated. Common examples are installation and delivery charges.⁵⁸

Under Streamlined, separable elements such as delivery⁵⁹ are not separated out if they are included in the definition of "sales price."⁶⁰ Additionally, packaging and items provided for free are not separated out.⁶¹ And as discussed above, TPP and service elements are combined if the TPP is essential to the use of the service, the TPP is provided exclusively with the service, and the true object is the service.⁶² A similar rule applies for multiple service elements. Multiple service elements are combined if the first service is essential to the second, the first service is provided exclusively with the second, and the true object is the second service.⁶³ Finally, a separable taxable element is disregarded if it is 10 percent or less than the total purchase or sales price.⁶⁴

In Texas, separable elements are not separated out if they are included in the definition of "sales price." For services, the entire charge is taxable if the taxable portion is more than 5 percent of the total. However, the presumption of taxability can be rebutted based on the taxpayer's books and records.⁶⁵

In Colorado, separable elements are not separated out if they are included in the definition of "purchase price." If not included in the definition of "purchase price," then there is separate tax treatment of separable elements.

In Tennessee, if two items are separable, they are analyzed as a bundled transaction if sold for a single price.⁶⁶ In Tennessee, tax is imposed on the entire sales price if two or more items are sold for a single price and one of the items is taxable.⁶⁷

⁵⁸ See, e.g., Miss. Code § 27-65-3(h) (definition of "gross proceeds of sale").

⁵⁹ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions; Streamlined Rules and Procedures, Rule 327.4.A.

⁶⁰ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions; Streamlined Rules and Procedures, Rule 330.1.B.1. "Sales price" presumably includes inseparable elements such as labor, materials costs, and so forth.

⁶¹ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions; Streamlined Rules and Procedures, Rule 330.1.B.1.

⁶² Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(1).

⁶³ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(2).

⁶⁴ Streamlined Agreement, Appendix C, Part 1, Administrative Definitions, para. (C)(3).

⁶⁵ See e.g., 34 Tex. Admin. Code § 3.330.

⁶⁶ Tenn. Ltr. Rul. 14-10.

⁶⁷ Tenn. Ltr. Rul. 14-10.

5. Federal law considerations

Two federal laws, the Internet Tax Freedom Act and Mobile Telecommunications Sourcing Act, contain language addressing bundling. Below we present the relevant language from each law, with links to the full language. State tax laws or other guidance may also reflect these provisions.

Additionally, the Digital Goods and Services Tax Fairness Act, which was last introduced in 2019, contains language relating to bundling. Its language is also included.

The approaches are similar in that they (1) provide that any bundle of taxable and nontaxable items sold for one price is subject to tax, and (2) allow a seller to unbundle the taxable and nontaxable amounts based on their books and records.

A. Internet Tax Freedom Act (ITFA)

The ITFA⁶⁸ accounting rule is included below.

SEC. 1106. ACCOUNTING RULE.

(a) In General.-If charges for Internet access are aggregated with and not separately stated from charges for telecommunications or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.”

(b) Definitions.-In this section:

(1) Charges for internet access.-The term 'charges for Internet access' means all charges for Internet access as defined in section 1105(5).

(2) Charges for telecommunications.-The term 'charges for telecommunications' means all charges for telecommunications, except to the extent such telecommunications are purchased, used, or sold by a provider of Internet access to provide Internet access or to otherwise enable users to access content, information or other services offered over the Internet.

B. Mobile Telecommunications Sourcing Act

The relevant language from the Mobile Telecommunications Sourcing Act⁶⁹ is included below.

⁶⁸ 47 U.S.C. § 151 note. Link [here](#).

⁶⁹ Pub. L. No. 106-252, 114 Stat. 630 (2000) (codified at 4 U.S.C. § 123). Link [here](#).

§ 123. Scope; special rules

....

(b) **ADDITIONAL TAXABLE CHARGES.**—If a taxing jurisdiction does not otherwise subject charges for mobile telecommunications services to taxation and if these charges are aggregated with and not separately stated from charges that are subject to taxation, then the charges for nontaxable mobile telecommunications services may be subject to taxation unless the home service provider can reasonably identify charges not subject to such tax, charge, or fee from its books and records that are kept in the regular course of business.

(c) **NONTAXABLE CHARGES.**—If a taxing jurisdiction does not subject charges for mobile telecommunications services to taxation, a customer may not rely upon the nontaxability of charges for mobile telecommunications services unless the customer’s home service provider separately states the charges for nontaxable mobile telecommunications services from taxable charges or the home service provider elects, after receiving a written request from the customer in the form required by the provider, to provide verifiable data based upon the home service provider’s books and records that are kept in the regular course of business that reasonably identifies the nontaxable charges.

See Appendix for listing of cases considering the ITFA and MTSA bundling rules.

C. Digital Goods and Services Tax Fairness Act

The Digital Goods and Services Tax Fairness Act⁷⁰ did not become law but its bundling language may be relevant and is included below.

SEC. 5. TREATMENT OF BUNDLED TRANSACTIONS, DIGITAL CODES, AND OTHER RULES.

(a) **BUNDLED TRANSACTION.**—If a charge for a distinct and identifiable covered electronic good or service is aggregated with and not separately stated from one or more charges for other distinct and identifiable goods or services, which may include other covered electronic goods or services, and any part of the aggregation is subject to taxation, then the entire aggregation may be subject to taxation, except to the extent that the seller can identify, by reasonable and verifiable standards, one or more charges for the nontaxable goods or services from its books and records kept in the ordinary course of business.

⁷⁰Digital Goods and Services Tax Fairness Act of 2019, S. 765, 116th Cong. (2019). Link [here](#).

6. Lessons learned / findings and conclusions

As stated in the introduction, the primary question this section of the digital products white paper addresses is:

Does the presence of digital products in a sales and use tax base present unique issues with respect to bundling compared to sales and use tax bases that are based on TPP and services?

These findings and conclusions highlight the questions policy makers should consider in creating a coherent policy framework for bundling in the digital space.

A. Definition of a bundle

One issue is whether a transaction is a bundle or instead a single product composed of a group of components. Compared to traditional products, components of digital products can more easily be removed or added, which can lead to disputes and discussions with tax agency staff regarding the nature of the product and how it works.

B. Tax software compliance coding

Bundling issues can significantly complicate tax software compliance coding. From discussions with stakeholders, the problem is the complexity of products and the multitude of states' approaches. A rule stating that any bundle with a given percentage of taxable components is taxable or not taxable can make things easier provided that the percentages of the various parts of the bundle can be determined.

A rule stating that a bundle is fully taxable or fully exempt would be the same rule, but with a percentage of 'anything above zero' on the one hand or a percentage of 'anything below 100 percent' on the other. For more on this, see discussion of the tainting rule in section 7.C.

C. Possible New Framework

Based on our research, the Streamlined Agreement contains the most comprehensive set of bundling rules. What follows is a proposal that combines the Streamlined approach and elements from other state approaches. There are various issues with both the Streamlined approach and other state approaches, for those, see sections 3 and 4 of this white paper.

This framework provides policymakers, tax administrators, and taxpayers with a relatively comprehensive and tested framework to address bundling issues. However, further refinement may be appropriate.

The framework first applies a threshold test before entering the formal bundling analysis. The framework then applies an objective test to determine if there is a bundled transaction,

before applying various exclusion tests to determine if the transaction should not be treated as a bundled transaction. Finally, the framework acknowledges the application of various unbundling provisions.

Step 1: A pre-bundling analysis.

Apply a threshold test to determine whether the transaction involves a single product.

The threshold test will partly serve to codify the notion that “if you can’t unbundle it, it’s not a bundle.” An integrated product should not be subject to breakup using the bundling rules. With TPP, this is intuitive, with digital products, not. Therefore, there is a need for an additional check before applying the bundling rules to digital products.

With TPP, it is generally accepted that a buyer may purchase a finished product that is comprised of multiple components, which together comprise a single, integrated, finished product that cannot be subdivided and treated as a stand-alone product. For example, the purchase of a customized wooden chair is comprised of a seat, arms, and legs that collectively consist of wood and metal in the form of screws and bolts and that are the product of labor and design services. There is less consensus as to what a single integrated finished *digital* product is.

Potential options:

- (1) Develop a separate definition of single, integrated product and apply that definition. Only transactions involving products that are not single, integrated products would be subject to the bundling rules.
- (2) Develop a nonexhaustive list of digital products that are deemed to be single, integrated products. Products on this list would be excluded from the bundling rules.
- (3) Define specific products to include components X, Y, and Z. The products on this list are not subject to the bundling rules with respect to their specified components.

Options (1) and (2) could be adopted together and work in tandem. Option (3) would likely be a standalone option. Whatever is used as the threshold step, there will be some overlap between that and the requirement for “distinct and identifiable” components in the bundling rules.

Step 2: Is this a bundled transaction?

A bundled transaction requires two or more “distinct and identifiable” products sold for one non-itemized price and excludes any transaction when the sales price varies or is negotiable,

based on the selection by the purchaser of the products included in the transaction. For this analysis, the following items are not distinct and identifiable products:

1. Elements of the sales price, e.g., material and labor costs
2. Packaging
3. Items offered for free

For this analysis, “one non-itemized price” does not include a price that is separately identified by product on binding sales documentation or other supporting sales-related documentation made available to the customer in paper or electronic form, including, but not limited to, an invoice, bill of sale, receipt, contract, service agreement, lease agreement, periodic notice of rates and services, rate card, or price list.

Step 3: Identify applicable exclusions

Exclusions allow policymakers the flexibility to apply different taxability rules. Potential exclusions include transactions where the true object of the transaction is not taxable, the taxable product is de minimis, or the transaction contains products from a specified industry and the other taxable products in the transaction are equal to or below the threshold percentage of the purchase price.

Step 4: Apply applicable post-transaction unbundling rules.

Allow unbundling of certain transactions, either under federal law, such as the Mobile Telecommunications Sourcing Act and Internet Tax Freedom Act, or under state law.

7. Appendices

A. Results of stakeholder discussions about bundling and digital products.

At the July 30, 2024 MTC Uniformity Committee meeting in Denver, Colorado, the digital products work group chair, vice-chair, and staff reported on stakeholder calls conducted with taxpayers, their representatives, and other non-state representatives to solicit input on their experiences and information about bundling and digital products.⁷¹

i. General observations

Many stakeholders explained that confusion exists when working with bundling issues across the states, regardless of whether the transaction includes digital products. Stakeholders cited

⁷¹ Add cite to the slides/presentation when added to the website.

confusion over identifying a bundle versus a single product with multiple attributes and identifying when to apply the true object test.

Some stakeholders, but not all, said bundling with digital products is more difficult than with traditional products. That said, stakeholders stated that businesses like bundles as they increase perceived value to purchasers. Bundles are considered necessary to stay competitive in certain industries, such as the telecommunications industry. Stakeholders stated that marketing staff, who are typically not responsible for taxability determinations, often want to sell a bundled product for a single price, inclusive of tax, to offer a better overall cost than what their competitors offer.

Stakeholders shared that digital apps frequently have various components or attributes which create confusion as to whether the item sold is a bundle. More than one stakeholder noted that all digital services have some component of software, and since software in many states is considered TPP, that causes tax administrators to look closely at the product. It was also noted that any digital attribute can be removed from a digital product, so digital products are not like tangible products.

Stakeholders mentioned the Internet Tax Freedom Act (ITFA)⁷² accounting rule and accompanying definitions and hinted that taxpayers and states are not as aware of the ITFA accounting rule as tax practitioners are.

Stakeholders mentioned that software maintenance services are common portions of bundles involving digital products.

Some stakeholders provided that streaming products often create disputes between taxpayers and tax agencies. According to stakeholders, tax agency staff often ask about the percentages associated with different parts of a streaming product or may request the percentage of downloads versus streamed views to determine taxability. Some stakeholders said the ability to download an otherwise streaming digital product should not cause the product to be treated as downloaded software, stating that the true object is the streaming.

ii. Coding compliance software

Stakeholders agreed that coding bundled products with the correct taxability determination is challenging for taxpayers and software vendors. One stakeholder shared that it had been working for years with its third-party software provider to customize the software to address the bundled products it sells. The same stakeholder stated that according to the provider the platform had been around for years and was still unable to offer standardized product and

⁷²The ITFA accounting rule language is presented in section 5.A.

taxability codes for bundled products because of the complexity and lack of uniformity across the states.

iii. Case-by-case determinations

Stakeholders reported negotiating with states to allow sellers and tax agencies to determine what taxability determination controls in specific situations. They also reported requesting letter rulings to address the taxability of bundled products when state guidance is not otherwise clear. Sometimes long-term negotiations between states and taxpayers are required for the tax agency to make a determination on whether a product is a bundle.

iv. Invoices vs. contracts

Stakeholders noted that when analyzing facts relating to a bundled transaction, or to make a determination whether the item sold is a bundle, details may exist in a contract about what is being purchased and how the product works to help auditors and tax agency staff. A lack of such detail may result in the unwillingness of tax agency staff to allow unbundling through an accounting rule.

v. Stakeholders Interviewed

Academics:

Andrew Appleby, Stetson College of Law

Streamlined Representatives:

Craig Johnson & Christie Comanita (work group ex officio members)

Sherry Hathaway & Michael Ward (TN)

Taxpayers:

Amazon – Jessie Eisenmenger & Roger Price

Apple – Terry Ryan and Sheila Bayley

Charter Communications – Brandi Drake

Practitioners & Taxpayer Representatives:

Eversheds Sutherland – Michele Borens and Charlie Helms

Kranz & Associates – Carolyn Kranz

Moss Adams – Phil Horwitz

MultiState Associates – Deborah Bierbaum

Yetter Tax – Diane Yetter

Pillsbury Winthrop Shaw Pittman - Zach Atkins

Organizations & Compliance Vendors:

Avalara – Scott Peterson (via comments to the press)
Council On State Taxation – Fred Nicely
SofTec – Mark Nebergall
Sovos – Charles (Chuck) Maniace
TaxCloud – Bruce Johnson

B. Examples of digital products in the marketplace and bundling issues.

In this subsection we identify examples of bundles drawn from staff research, stakeholder discussions, and work group members.

i. Stakeholder Examples

1. Digital codes entitle the buyer to digital products, services, and TPP, or some combination. An example is a digital code that entitles the purchaser to a streaming movie and a bag of chips.
2. Free items may be given away with a digital product that is sold. An example is a streaming concert video and a t-shirt.
3. Exercise equipment sold with streaming video services.
4. Software maintenance services.

ii. Work Group Member Examples

1. Software as a service (SaaS) that comes with an app (software). Assume a state does not tax SaaS but does tax software as TPP. When the SaaS subscription includes the app that allows the purchaser to more easily access the SaaS platform, is the transaction taxable?
2. Charges for personal services (e.g., training or consulting) or a membership to a trade or professional organization that include access to a digital library of forms, templates, articles, and/or training videos.
3. Vendor's non-itemized offering includes the following:
 - a. The right to use an online portal to access the vendor's proprietary digital research library;
 - b. The right to receive personal consulting from professional analysts; and
 - c. The right to view pre-recorded online presentations, meetings, or workshops.
4. Vendor's non-itemized offering includes the following:
 - a. The right to access a Communications as a Service platform, which includes access to use VOIP, SMS/MMS texting through IP protocol, instant messaging, and audio/video conferencing tools;

- b. The ability to store and manage data (storage and management of communication data); and
 - c. The ability to integrate (e.g., through an Application Programmable Interface) the software platform with other 3rd party software.
5. Vendor's non-itemized offering includes following:
 - a. Lease of a live-stream camera with unlimited 4G LTE Data;
 - b. A web-based platform to access the live video streaming of a location (e.g., construction site);
 - c. The ability to control the camera through customer's computers or electronic devices;
 - d. Unlimited storage of videos;
 - e. Access to weather data; and
 - f. Ability to create time-lapsing videos/photos.
6. Vendor's non-itemized offering is the sale of a Non-Fungible Token that provides the owner with the following:
 - a. Free admission to a set number of music concerts annually – (sourced to respective state);
 - b. Access to in-person educational events;
 - c. Lifetime subscription to video streaming service;
 - d. Lifetime subscription to downloadable software; and
 - e. Lifetime subscription to music streaming service.
7. Vendor's non-itemized offering is the sale of remote access software, providing users with the following:
 - a. The right to exclusive and remote use of the software product;
 - b. The ability to download an application (e.g., mobile, desktop, tablet) that provides access to the vendor's remote access software but provides no offline functionality for the user; and
 - c. The ability to create 3D renderings of a building or structure that can be downloaded or shared via email.
8. Vendor's non-itemized offering is the sale of remote access software, providing users with the following:
 - a. The right to remote use of the software product;
 - b. The ability to download an application (e.g., mobile, desktop, tablet) that provides access to the vendor's remote access software. The downloaded application includes various offline functionalities when not connected to the vendor's platform, such as:
 - i. The ability for the user to take pictures within the application installed on their device;

- ii. Data storage within the user's device; and
 - iii. Geolocation tracking features, such as:
 - 1. Location history logging
 - 2. The ability to tag the location where photos are taken or data is collected; and
 - c. The ability to create 3D renderings of a building or structure that can be downloaded or shared via email.
9. College Application Platform — Ready for School

The Taxpayer provides an online application platform (Ready for School), which is a SaaS platform. Ready for School is used by schools for two purposes. The first, Best Document Admin (BDA), is for prospective students to send in their application materials and pay deposits. The second, Easy Document Review (EDR), is for the educational institution to review the applications. Each of these functions is a separate SaaS platform used by the school and each is sold for one non-itemized price.

The Taxpayer summarizes the BDA SaaS platform as comprising four distinct components: (1) Document Processing (for applicants' applications), (2) Data Hosting (for applicants' information), (3) Payment Processing (for applicants to pay), and (4) Administrative Tools (for school to view, search, and retrieve applicants' data), which are sold together for one non-itemized price. The Taxpayer asserts that because of the components' separate functionality, the BDA is not a single product. The Taxpayer argues the component parts are distinct and identifiable products. The Taxpayer argues that the BDA SaaS platform is a bundle because it has four features: document processing, data hosting, payment processing, and administrative tools. The Taxpayer claims that each of the four features is an individual product. Additionally, the Taxpayer argues that the first three components listed above qualify for specific exclusions from tax. The Taxpayer argues the administrative tools, while arguably taxable, have a cost relative to the entire package that is de minimis. Alternatively, the Taxpayer argues the true object of the administrative tools, that consist of taxable products such as electronic search functionality and data processing, is exempt data processing. Or, alternatively, the administrative tools constitute a bundle and the taxable products are de minimis.

The second SaaS platform used by schools is the Easy Document Review platform (EDR), which manages the entire application review process online. This platform can be purchased separately from BDA. EDR collects all reviewers' scores and

comments into a single location. Applications are routed to the appropriate department. Built-in search tools make it easy for evaluators to retrieve and compare applications. EDR is customized for each educational institution based on their unique needs. EDR fully integrates several other Ready for School SaaS platforms, including those for potential students to upload letters of recommendation, verify credentials, and solicit prospective students to apply. Customers would pay for each additional platform separately. All data shared between the platforms is automatic. The EDR platform is sold for one non-itemized price. The Taxpayer argues that EDR is a single product and is exempt as customization of prewritten software.

Whether someone is an employee of the university or a prospective student, they log onto the same Ready for School SaaS platform and have access to all the different platforms — BDA, EDR, or any additional platforms into which the customer has opted into. When Ready for School bills their customers, they itemize their invoices with a price for each individual platform that is integrated into the Ready for School SaaS platform.

10. Online Banking Platform — GreenThumb

GreenThumb is an online banking platform built by the Taxpayer that allows financial entities (FT) to provide a variety of features to their customers including: paying bills, accessing electronic account statements, making balance transfers, accessing credit card accounts, checking their available credit, reviewing account data, ordering statements for the preceding year, requesting replacement cards and PIN numbers, updating account contact information, requesting a current credit score, initiating inquiries about payments and transactions, and reporting a lost or stolen card. To provide all these services, the Taxpayer retrieves data from a variety of databases. The Taxpayer maintains a website that hosts and manages the data pulls for each of the FT's selected options. Each individual FT selects its own preferences and options available for their customers separately.

The Taxpayer provides representative monthly billing statements to the FTs that include: a fee per unique user, a custom programming fee, a monthly maintenance fee, and separate charges for cardholder statement requests and reporting lost/stolen cards. The Taxpayer argues that the GreenThumb platform, is a single product, that qualifies for an exclusion from tax as a payment processing service. The Department has determined that some of the features, if sold alone, would be taxable digital services.

The Taxpayer charges the individual FTs one non-itemized, but scalable, priced based on the number of users of the service. The Taxpayer bills for access to GreenThumb, which is an online banking platform. The membership fee per user for GreenThumb includes all the services that comprise the program, such as paying bills, accessing electronic account statements, and making balance transfers. Additionally, the Taxpayer charges separately for services related to GreenThumb, such as custom programming fee, a monthly maintenance fee, and separate charges for cardholder statement requests, and reporting lost/stolen cards.

C. Approaches to addressing bundling issues

In researching bundling and gathering information from stakeholders, we identified several current or potential approaches to bundling. These approaches might be considered by states for use in the digital products context.

i. Simple Tainting Rule

The presence of any taxable component in a bundle, typically two or more products sold for a single price, means the whole bundle is taxable.

Pros:

- Easy for sellers to apply and explain to purchasers.
- Less audit risk.

Cons:

- Purchasers may push back and not want to pay tax on the full amount.
- May negatively impact businesses or industries that states want to preference, e.g., agriculture or health care services.

Stakeholder comments: Positions on this approach were polarized, some stakeholders liked it and others did not. It seems to depend on the nature of a taxpayer's business model and industry.

ii. De minimis Rule

The presence of taxable components does not make the entire bundle taxable if the taxable components do not exceed some threshold of the cost or purchase price of the total bundle.

A de minimis rule might be viewed as an exception to the tainting rule, since a tainting rule will mean that tax is applied to the total sales price because at least one item in the bundle is

taxable. As noted above, if a tainting rule is universally applied, it may have negative impacts or create results that seem unfair or contrary to legislative or state policy prerogatives.

Imagine, for example, a nontaxable car wash service where the tires are treated with Armor All®. The Armor All® is not washed off, it goes down the road with the car. Under these facts, taxable TPP – the Armor All® - was transferred with the service, making the entire charge taxable. Whereas a competing carwash that does not treat tires with Armor All® will have no obligation to collect tax on the sale. Applying a de minimis rule can help to ameliorate some of these impacts by, for example, allowing for a determination that the cost of the Armor All® compared to all the other costs that the seller incurs to provide the car wash service, such as the water, soap, and labor, is de minimis and not enough to make the otherwise nontaxable service taxable.

However, a de minimis rule can be measured in different ways, by relative costs of the taxable and nontaxable portions (as in the above example), by cost of the taxable portions relative to the total purchase price, by an incidental standard, or other some other objective or subjective criteria. A de minimis rule can promote reasonable outcomes that states and taxpayers can agree to. The weakness is that it is hard to define exactly what qualifies as de minimis.

In addition, here are questions that arise when thinking about using a de minimis rule:

- Can taxability be determined based on verifiable cost information of the bundled products?
- What costs control – input or output costs? May be harder to determine in the digital realm when there are fewer comparison products available.
- What should the threshold be? Is 5-10 percent too low to make a difference? Is 20 percent better to allow taxpayers and tax administrators to feel more comfortable about the outcome?
- What is the philosophy behind the 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? If so, the threshold should be low. Does a de minimis rule create fairness? If so, the threshold should be higher so that taxing the entire bundle does not seem unreasonable.

Pros:

- Reduces concerns about unfairness.
- Promotes sustainability of a state's overall bundling regime by avoiding results that might be perceived as overly harsh.

Cons:

- Adds complexity to tax administration.
- Determining the value of digital products may be challenging in some cases.

Stakeholder comments: Some like it and others don't. It seems to depend on the nature of a taxpayer's business model and industry.

iii. Streamlined Agreement and Related Rules

The Streamlined Sales and Use Tax Governing Board has developed a comprehensive set of bundling rules. For detail on those rules, see section 3.

Pros:

- Provides a consistent and comprehensive framework for addressing bundling issues that supports efficient tax administration.
- Used in 24 states.
- Incorporates, partially, objective criteria.
- Gives sellers the flexibility to bundle or unbundle if there are concerns about tax consequences.

ii: Cons:

- Can be complex to administer in certain situations.
- Incorporate partially subjective criteria.

Stakeholder comments: Some said Streamlined has the best approach to bundling and covers digital products well, so states should look no further and not create alternative bundling rules. Others said the Streamlined approach is good but could use an update for digital products since they were not considered when the rules were developed. Still others said Streamlined does not cover digital products well because digital components are often not distinct and identifiable (a condition under Streamlined to be a bundle). Some said the "distinct and identifiable" concept from Streamlined is hard to distill with digital products; therefore, the Streamlined approach is unhelpful. Finally, even with any shortcomings, stakeholders indicated that Streamlined states are easier to navigate on bundling issues than non-Streamlined states.

iv. Accounting Rule (aka the unbundling rule)

Sellers can charge a single price for a bundled product but collect and pay tax only on the taxable portions based on a reasonable unbundling of the transaction based on their books and records.

Pros:

- Provides flexibility to sellers and recognizes the unique needs of different sellers in different industries.
- Allows businesses to market a transaction for a single price without tax consequences.
- Preferred approach of the telecom industry; also memorialized in ITFA and MTSA.

Cons:

- Adds complexity and reduces transparency as the public price will suggest nothing of the tax treatment.
- If allowed only for certain industries, those not included may feel they are being treated unfairly.
- May have more audit risk.
- Difficult for third party compliance vendors to program in their systems.

Stakeholder comments: Some stakeholders voiced a preference for the accounting rule due to their business preference of selling complicate bundles for one price. The rule is part of the Internet Tax Freedom Act and Mobile Telecommunications Sourcing Act. For more detailed information, see section 5. It is also part of many states' laws.⁷³ Stakeholders reported that with respect to the telecommunications industry the rule has created few disputes across the states. Stakeholders explained that the accounting rule can be helpful for staying in compliance with non-tax regulations.

However, stakeholders also mentioned that the accounting rule is less transparent for purchasers, who have a harder time understanding how tax is calculated, and creates more

⁷³ For example, Tex. Tax Code Ann. § 151.025(d) states: "If any nontaxable charges are combined with and not separately stated from taxable telecommunications service charges on the customer bill or invoice of a provider of telecommunications services, the combined charge is subject to tax unless the provider can identify the portion of the charges that are nontaxable through the provider's books and records kept in the regular course of business. If the nontaxable charges cannot reasonably be identified, the charges from the sale of both nontaxable services and taxable telecommunications services are attributable to taxable telecommunications services. The provider of telecommunications services has the burden of proving nontaxable charges."

audit risk for sellers if they do not get the accounting right. Some stakeholders said everyone should be able to use the accounting rule if it fits their business needs.

v. Hierarchy/Decision Tree

One stakeholder suggested creating a new approach based on a hierarchy that helps taxpayers and tax administrators think through various factors and fact patterns, with perhaps the ultimate default in the hierarchy/decision tree concluding the bundle is taxable. No specific example of what that might look like was provided. It could resemble a list of options, as presented in this white paper, to approach bundling issues given that different fact patterns might lend themselves to better approaches than others. Or, a state could identify what approaches to bundling they would consider or not.

vi. True Object of the Transaction

This is a common test that has been around for a long time. For more, see section 4.C. of this whitepaper. Still, questions arise such as: Whose perspective, the seller's or the purchaser's, controls the true object analysis? Some stakeholders suggested states consider using a "reasonably prudent buyer" perspective to ensure everyone starts the analysis from the same perspective. Also, what objective considerations play a role in the analysis, if any?

Pros:

- Seeks to base taxability on what the purchaser is buying, which can lead to tax results that correspond to the purchaser's expectations.
- The test is common across many states.

Cons:

- Subjective, leading to inconsistent application or unpredictable results.
- Facts-specific.
- Complex.
- Unclear what factors should be used to determine the true object and what weight those factors should be given.
- Invites disputes as to what the true object is.

Stakeholder comments: Some said the true object is superior to a tainting rule because it is more accurate. Others said the true object test is too subjective and a more objective test, based for example on comparable cost data across similar industries, is more accurate. Several stakeholders noted that when working with the true object test, disputes with tax agency staff can arise over whether the seller or purchaser perspective controls. Some

suggested greater clarity could be achieved by using a “reasonably prudent buyer” standard for determining the true object of a bundled transaction.

vii. **Apply a Taxability Percentage**

Streamlined section 330 concerns “Bundled Transactions.” Subsection 330.D.3. could be used as a model to develop an approach that would provide that in certain circumstances some percentage of the transaction will be deemed taxable. This could be phrased as a rebuttable or an irrebuttable presumption. One stakeholder shared the example of a subscription service that allows the subscriber to select products from a menu that includes both digital and non-digital products. Payments would typically be made in advance and neither the customer nor the seller would know what allocation may be appropriate at the time of billing. Ease of administration might suggest a single taxable percentage for the monthly charge, regardless of the actual usage in any month.

For background, while not addressing digital products, Streamlined section 330 provides in relevant part as follows:

D. In the case of a transaction that includes an “optional computer software maintenance contract” for prewritten computer software and the state otherwise has not specifically imposed tax on the retail sale of computer software maintenance contracts, the following provisions apply:

....

2. If an optional computer software maintenance contract only obligates the vendor to provide support services, it will be characterized as a sale of services and a state may use any of the methods provided under subsection (D)(3) to determine the taxable and nontaxable or exempt portions.

3. If an optional computer software maintenance contract is a bundled transaction in which both taxable and nontaxable or exempt products that are not separately itemized on the invoice or similar billing document, then states shall elect one of the following tax treatments:

....

d. The contract shall be characterized as twenty, thirty, forty or fifty percent taxable or eighty, seventy, sixty and fifty percent nontaxable or exempt respectively, as selected by each member state.

4. With respect to states that elect the method described in subparagraph 3(b):

a. Such states may prescribe the use of such reasonable methods as it deems appropriate, and

b. The method selected by the seller shall be binding on the purchaser.

The accompanying rule to Streamlined Agreement section 330.3 (Allocations with respect to Prewritten Computer Software Maintenance Contracts) provides: “Each state may elect one uniform percentage within the range allowed under Section 330 (D)(3)(d) for allocating between taxable and nontaxable or exempt products.”

Pros:

- May promote consistent results.
- Eliminates the all-or-nothing approach to bundling.
- May be perceived as more fair.

Cons:

- Likely cannot apply broadly to all bundling situations.
- The percentage applied could be viewed as arbitrary.

D. Cases and other guidance on the ITFA and MTSA Accounting Rules

In the Matter of the Petition of Helio, LLC, DTA No. 825010 (N.Y. Tax Appeals 2015). In *Helio*, the Tax Appeals Tribunal briefly considered the MTSA accounting rule. The Tribunal ruled the accounting rule was not applicable to the situation. Relevant to this document, the applicability of the accounting rule turned on its first phrase: “If a taxing jurisdiction does not otherwise subject charges for mobile telecommunications services to taxation.” The tribunal found that New York did subject the services to taxation therefore the accounting rule was inapplicable. This phrase does not appear in the ITFA accounting rule.

J2 Cloud Servs., Inc. (f/k/a J2 Glob., Inc. & J2 Glob. Commc’ns, Inc.) v. Comm’r of Revenue, Docket No. C325426, 2019 WL 1102964, at *17 (Mass. App. Tax. Bd. Feb. 27, 2019). In *J2 Cloud Services*, the Massachusetts Appellate Tax Board determined the taxpayer’s offerings were not Internet access. Therefore, the ITFA accounting rule was not implicated

directly. The court did mention the ITFA accounting rule, describing it as a “requisite” to the protections for Internet access, akin to the requirements for screening software required under ITFA.

New York State Department of Taxation and Finance, TSB-A-08(47)S (October 16, 2008). New York determined that an Internet cafe’s charges for Internet access and taxable software were separately determinable for purposes of the accounting rule. The Department cited to the end screen shown at the close of each session that displayed the time spent and charges for accessing the Internet and the time spent and charges for using the software.

New York State Department of Taxation and Finance, TSB-A-17(2)S (February 27, 2017); see also, TSB-A-09(17)C/TSB-A-09(60)S (December 15, 2009). New York provided that to satisfy the accounting rule the charges for Internet access must be “readily identifiable,” determined using an “objective and verifiable” standard, and reasonable in relation to the total charge.

Minn. DOR, Rev. Notice #03-10 June 8, 2009).

Kansas Priv. Ltr. Rul. 2011-003. Kansas advised taxpayers to both separately state their charges for Internet access and keep books and records to substantiate the amounts.