

SALT Alert! 2026-15: California: CDTFA issues updated emergency proposed regulations on digital products

The California Department of Tax and Fee Administration (CDTFA) has released updated emergency proposed regulations to implement Senate Bill (S.B.) 122's expansion of sales and use tax to "digital products," effective January 1, 2027. (For more information on S.B. 122, please see our previous SALT Alert). In September, the CDTFA had released a Discussion Paper with the text of the proposed regulations and a request for suggestions and comments from the public. The new draft regulations revised by the CDTFA provide additional guidance on the scope of taxable digital products, the $5 million purchaser use tax liability threshold, sourcing rules, and the use of multiple points of use (MPU) and direct payment certificates. Some of the key updates to the regulations are summarized below.

Regulation 1600 – Application of Sales and Use Tax to Digital Products

The proposed regulation clarifies the scope of the definition of "digital products" and how sales and use tax will generally apply to transactions:

- **Definition and exclusions.** "Digital product" excludes "digital infrastructure," which has an expanded definition but is still generally intended to capture cloud infrastructure services such as IaaS as nontaxable. The definition also excludes "digital video game products" such as electronically delivered or remotely accessed games and in-game purchases used primarily for

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entertainment. However, a digital video game product created with the primary intention of being used for educational or training purposes is not excluded from the definition of a digital product and may be taxable.

- **True object test.** The regulation confirms that Regulation 1501's "true object" test applies in determining whether a transaction is a taxable sale of a digital product or a service with an incidental digital component. A relevant factor is the relative value of the digital product compared to the services in the transaction.

- **Maintenance and updates.** Amounts charged for mandatory maintenance contracts are taxable as part of the sale of a digital product. Separately stated charges for optional maintenance contracts are not taxable, but digital product updates and enhancements are taxable. Where optional maintenance is bundled with taxable updates or enhancements in a single lump-sum charge, and that charge does not exceed the original price of the digital product, 25 percent of the charge is treated as taxable and 75 percent as nontaxable.

- **Server location.** For purposes of determining whether sales or use tax applies, the delivery of a digital product from a server located in California is not, by itself, considered participation in the sale from a California place of business of the retailer.

The regulation also provides detailed sourcing and timing rules:

- **Place of sale.** If the purchaser provides a California address during the consummation of the sale, that in-state address is the purchaser's known address for sourcing. If the purchaser only provides an out-of-state address and has not provided an in-state address within the prior 12 months, the out-of-state address controls for sourcing. If the purchaser has provided an in-state address within the last 12 months, the seller must obtain an exemption certificate to source the sale outside California; if the purchaser does not provide such a certificate, the in-state address controls.

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- **Place of use.** A seller obligated to collect use tax must make reasonable efforts to obtain complete and accurate address information to determine place of use. This includes obtaining written verification of the addresses where first use is expected to occur. If written verification cannot be obtained, the seller must collect use tax based on the purchaser's known in-state address.

- **Timing of sales.** Each transfer of a right to use a digital product is a separate sale. Generally, a transfer is treated as occurring upon the purchaser's acceptance of the contract or agreement granting that right, unless the agreement specifies a later date or imposes a condition, in which case the transfer occurs when the condition is satisfied. If there is no agreement, the sale occurs upon completion of the transfer of the digital product. Renewals, extensions, or reinstatements of rights to use a digital product for additional consideration are treated as new sales occurring on the date of renewal, extension, or reinstatement. Modifications to a digital product for additional consideration beyond what was initially granted are also treated as new sales.

Regulation 1600.1 – Tax Liability Threshold for Digital Products

S.B. 122 relieves a retailer of sales and use tax collection obligations and shifts responsibility for accruing and remitting use tax to the purchaser once that purchaser's annual purchases of digital products from the retailer exceed $5 million. The proposed regulation clarifies that, for purposes of calculating whether this $5 million threshold has been met, "amounts subject to sales or use tax" include transactions for which a purchaser issued either (1) a blanket MPU certificate or (2) a use tax direct payment exemption certificate to the seller. By contrast, the threshold does not include (1) the nontaxable measure identified on a single-transaction MPU certificate, or (2) exempt purchases identified in an exemption certificate where multiple digital products are purchased and some are identified as solely for use outside California.

The CDTFA may grant a waiver to allow a retailer to continue collecting tax when necessary for efficient administration, including where the purchaser is not otherwise required to be registered, does not

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anticipate additional purchases from the retailer, or the transaction does not involve multiple places of use, or the places of use are known at the time of the transaction.

Regulation 1600.2 – Digital Products Purchased for Multiple Points of Use

The proposed MPU rules distinguish between single-transaction MPU certificates and blanket MPU certificates. Where a purchaser issues a single-transaction MPU certificate, the seller remains liable for the payment and remittance of tax on the calculated measure attributable to use of the digital product in California. The MPU certificate must describe the digital products purchased for multiple points of use, state the calculated measure of tax, and describe the method used to determine that measure. A blanket MPU certificate, by contrast, generally relieves the seller from collecting and remitting sales and use tax and remains effective until revised or withdrawn. However, if a purchaser issues a purchase order stating that a particular purchase of digital products is entirely for use in California, the blanket MPU certificate does not apply to that transaction. A purchaser must be registered with the CDTFA to issue a blanket MPU certificate.

Regulation 1699.6 – Use Tax Direct Payment Permits

The proposed regulation clarifies the interaction between use tax direct payment permits and S.B. 122's digital product rules. A use tax direct payment exemption certificate applies only to transactions subject to use tax, not sales tax. A retailer making sales of digital products subject to sales tax cannot accept in good faith a purchaser's use tax direct payment exemption certificate when the retailer knows that the transaction is subject to sales tax and that the purchaser has not exceeded the $5 million threshold – even if the purchaser holds a direct payment permit for other types of purchases. By contrast, retailers making sales that are subject to use tax may accept a purchaser's use tax direct payment permit in good faith even if the purchaser has not exceeded the $5 million threshold.

Contacts

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For questions about the proposed regulations and their implications for your business, please contact Jim Kuhl or another member of the California indirect tax team.

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