

STATE OF COLORADO

DEPARTMENT OF REVENUE

State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
FAX (303) 866-2400



Bill Ritter, Jr.
Governor

Roxanne Huber
Executive Director

PLR-2009-002

March 25, 2009

XXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: XXXXXXXXXXXXX

Dear XXXXXXXXXXXX,

You submitted a request for a private letter ruling on behalf of your client, XXXXXXXXX Corporation ("Company"). This letter constitutes the Department ruling.

Issue

How should the Company apportion its income that is derived from various sales revenues and transactional fees generated in connection with prepaid debit cards?

Background

The Company is a marketer and processor of prepaid debit cards and prepaid debit card services throughout the United States. The Company's network includes more than XXXXXXXX retailers, check cashing locations and supermarkets. Independent agency agreements are executed between the Company and its retailers / distributors. The Company uses a combination of proprietary digital processing, new account representatives and customer service representatives to deliver services to customers. All debit cards are issued by third party banks, with the Company acting as an authorized independent sales organization of these banks.

The Company's core products include general purpose reloadable cards (GPR"), gift cards, and XXXXXXXX [brand name] cards. GPRs operate like bank debit products. Money can be deposited onto the card by direct deposit, at a terminal or retail location, through a person-to-person payment, or online. Gift cards hold a pre-configured amount of money and cannot be reloaded. XXXXXXXX [brand name] cards are a hybrid between GPR and gift cards; they can only be reloaded up to three times. All cards

carry the Visa or MasterCard acceptance marks.

The Company derives income from a variety of fees charged in connection with the issuance and subsequent use of the prepaid cards. The card is issued for a set amount, otherwise known as a fulfillment fee. Once money is loaded onto the card, various transaction fees are collected. These transactional fees include interchange fees, (signature fees and PIN purchase fees), monthly service fees, account maintenance fees, lost or stolen card fees, convenience fees, and balance inquiry fees. The Company's transactional fees account for a majority of total revenues whereas the fulfillment fees account for a relatively small portion of total revenue. The Company tracks card sales (e.g., fulfillment fees) on a state-by-state basis according to the location of the transaction. The company's transactional fees are not currently tracked on a state-by-state basis because the systems have not been created to allow for such tracking.

The Company's corporate offices and headquarters are based in XXXXXXXX [a state other than Colorado]. The majority of the company's employees are stationed at the company's headquarters. In addition, the Company maintains an inventory of its debit cards throughout the United States. These debit cards are manufactured by various vendors and shipped to the Company's main distribution warehouses. The cards are stored in the warehouses until they are needed and shipped to retailers throughout the country. The Company holds legal title to the inventory during the entire distribution process.

The Company employs regional account managers, located in XXXXXXXX states, who solicit business from new distributors and maintain relationships with existing distributors. The account managers educate and train distributor's employees, set sales goals for distributors, ensure that the distributors have the correct point of sales, and assist the distributor with the marketing of the Company's cards.

The Company generates revenue from the following transactions in the ordinary course of business:

1. Sale of debit cards. (GPR cards, gift cards, XXXXXXXXXXXX [brand name] Cards, etc.). The card is issued for a set amount, otherwise known as the fulfillment fee.
2. Transactional Revenue.
 - a. Interchange Fees. ("Signature fees" and "PIN purchase fees"). These fees are charged by the issuing bank to the merchant's bank for processing the cardholder's purchase transaction. The purchase transactions are processed by third-party processors (e.g., XXXXXXXX). These third party processors are located in various states and perform the processing services in various locations. The Company receives a portion of this interchange fee from the issuing bank pursuant to a revenue sharing agreement.

- b. Service Revenue. The maintenance of the cardholder's account is controlled by the Company's proprietary digital processing intellectual property and the Company's employees who are located in XXXXXXXXXXXX[a state other than Colorado]. The Company charges cardholders various service fees associated with the maintenance and use of outstanding cards. The typical service fees include the following:
- i. Service Fee (per transaction or monthly) – charged each time the card is used. Alternatively, the customer can pay a monthly service fee that allows for multiple transactions (rather than paying a fee on a per transaction basis).
 - ii. Account Maintenance fees – charged for each reloadable card with an inactive balance exceeding 90 days. Gift card accounts are charge an account maintenance fee for inactive account balances exceeding 6 months.
 - iii. Lost or stolen card fees – charged for replacing a lost or stolen card.
 - iv. Balance inquiry fee –charged for inquiring into the balance of their account.
 - v. Account-to-account transfer fee –charged for transferring funds from one Company cardholder account to another.
 - vi. Check fee –charged for issuing a check to close an account.

Discussion.

For tax years beginning on or after January 1, 2009, a corporation that derives income from sources within and outside Colorado must allocate and apportion its income pursuant to the single factor apportionment methodology set forth in §39-22-303.5, C.R.S. In general, this methodology apportions business income based on the source of the corporation's sales.¹ Income derived from services is sourced between and among the state(s) in proportion to the amount of costs incurred in each state where the services are performed.

There are certain exceptions to this general "cost of performance" rule. Colorado, as is true of many other states, has special apportionment and allocation rules for certain industries. One such exception is for financial institutions.² Income generated by

¹ For tax years beginning before January 1, 2009, a corporation had an election to apportion and allocate income using either a two-factor (revenues and property factors) or three factor (receipts, payroll, and property) methodology. §39-22-303, C.R.S. and §24-60-1301, C.R.S.

² Colorado, as is true of most other states, adopted the Multi-state Tax Commission's financial institution regulation that uses the "market" approach to apportioning income for financial institutions. Colo. Code

financial institutions is apportioned based on the location of the market exploited by the taxpayer and not where the costs of performance are incurred. More specifically, income generated by credit card operations of financial institutions is apportioned between and among states based on the billing address of the cardholder or the commercial domicile of the merchant, and not on the location of the infrastructure and labor costs incurred by the taxpayer to provide those credit card services.³

The principal issue raised by your request is whether the Company fairly falls within the regulation governing financial institutions. Financial institutions are, among other entities, banks and thrift institutions, savings and loans associations, corporations that generate fifty percent or more of their income from finance leases, and, importantly, “[a]ny other person or business entity, other than an insurance company taxable under C.R.S. 10-3-209, which derives more than fifty percent (50%) of its gross income from activities that a person described in subsections (2) through (7) and (9) above is authorized to transact.” Department regulation 1 CCR 201-3(l)(2)(h)(10); § 39-22-303.5(7)(a), C.R.S.

Most banks engage in credit and debit card operations and those operations include a variety of services and related charges, including:

1. Reimbursement fees to a merchant’s bank because one of the persons to whom the taxpayer bank has issued a credit card has charged merchandise or services to the credit card.
2. Interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees.
3. Net gains from the sale of credit card receivables.
4. Receipts from merchant discounts, which are the fees (or negotiated discount) charged to a merchant by the taxpayer bank for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

Regs. 1 CCR 201-3, p. 37 Financial Institution regulation. This regulation uses the familiar three factor (receipts, payroll, and property) methodology and applies to tax years beginning before January 1, 2009. As noted above, Colorado recently enacted a single factor apportionment approach for tax years beginning on or after January 1, 2009. The department is in the process of modifying the current financial institution regulation to be consistent with the new single factor methodology. In the interim, the department uses the receipts factor methodology of the current regulation for apportioning income of financial institutions.

³ A number of states treat credit card service operations as operations of a financial institution. Hellerstein & Hellerstein: *State Taxation*, Part IV, Chapter 10, ¶10.06. Compare, Conn. Gen. Stat. § 12-218(j) (credit card fees apportioned based on billing address of cardholder); Ind. Code §6-5.5-4-8 (apportioned to billing address of cardholder); Kan. Stat. Ann. § 79-1130; Utah Department of Revenue Regulation R8656F-32B and 32C; Va. Code § 58.1-418 (financial corporation is an entity that receives fees, commissions, and other compensation for financial services, including credit card operations); Wis. Admin. Code Tax 2.49(4)(g)-(j) (substantially same rule as Colorado regulation for apportionment of income for financial institutions).

The Company's debit card operates and generates fees in substantially the same manner as credit card operations. The Company issues debit cards, which carry either the Visa or MasterCard acceptance marks. Cardholders use these cards to purchase goods and services from merchants. A merchant extends credit to a cardholder subject to the purchase clearing through the various financial institutions. The merchant's financial institution issues the merchant a credit to its account. The merchant's financial institution, in turn, is reimbursed by the issuing financial institution with which the Company has an agreement. The issuing financial institution charges the merchant's bank an "interchange fee" for processing the cardholder's purchase. The Company is paid a percentage of the interchange fee. The Company's debit card operations are substantially the same as the operations of a credit cards operation of other financial institutions.

Moreover, the fees the Company charges cardholders are similar to the fees typically charged to credit cardholders. Financial institutions that issue credit cards often receive interest revenue from the cardholders based on the amount of credit extended, charge annual membership fees, charge fees for issuing checks on closed accounts, charge for transfers of funds between accounts, and charge fees for a variety of related services. The Company charges fees that are substantially the same as those of other financial institutions.

For these reasons, the Company fairly falls within subsection (h)(10) of the financial institution regulation.⁴ We acknowledge that the existing financial institution regulation does not specifically address debit card or prepaid card operations. We also acknowledge that debit and prepaid cards operate somewhat differently than credit cards.⁵ However, the differences do not suggest that a fundamentally different apportionment methodology is warranted. We also note that it appears that the few states which have specifically addressed apportionment of income from debit or pre-paid card operations have apportioned this income in the same manner as income from credit card operations.⁶

Turning to the various fees outlined in your request, income from these fees should be sourced as follows:

1. Fulfillment fees are sourced to the states in which the sale of the card to the cardholder occurred.
2. Interchange fees are sourced to the states where the merchant is located at the time of the purchase by the cardholder.

⁴ Compare, Indiana Letter of Finding No. 04-0430, 10/01/2005 (company that provided marketing, data processing, and administrative services related to credit cards is a financial institution for purposes of apportionment of income regulation).

⁵ Unlike credit cards, a debit and pre-paid cardholder has funds on deposit with a financial institution and from which the cardholder's purchase is debited.

⁶ Indiana Commissioner's Directive 14, 08/20/1990; Wis. Admin. Code Tax 2.49(2)(d) Apportionment of apportionable income of interstate financial institutions.

3. Service fees, account maintenance fees, lost or stolen card fees, balance inquiry fees, account-to-account transfer fees, and check fees are sourced to the states in which the cardholders' billing addresses are located.

Miscellaneous

This ruling is premised on the assumption that the Company has completely and accurately disclosed all material facts. The department reserves the right, among others, to independently evaluate the Company's representations. This ruling is null and void if any such representation is incorrect or incomplete and has a material bearing on the conclusions reached in this ruling.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Tele: (303)866-5627
Email: ntillquist@spike.dor.state.co.us