

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-11(1)C
Corporation Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C090108A

A petition received by the Department requests an advisory opinion regarding the way receipts of [REDACTED] (“Petitioner”) should be allocated for purposes of calculating the numerator of the receipts factor of the business allocation percentage under Tax Law Article 9-A. Petitioner’s receipts from the sale of prepaid debit cards should be allocated to New York in accordance with the location where the cards are sold. The transaction receipts associated with the prepaid debit cards should be allocated to New York based on where the cardholder performs a transaction.

Facts

Petitioner is a third-party marketer and processor of prepaid debit cards and prepaid debit card services throughout the U.S. Petitioner contracts with banks (“issuing banks”) to manage the prepaid debit cards connected with the bank’s depository accounts, using petitioner’s proprietary software program, new account representatives, and customer service representatives. Petitioner facilitates the sale, activation, load, reload, use, reporting, and regulatory compliance related to the prepaid debit cards. As part of this process, Petitioner distributes the prepaid debit cards through designated third-party distributors (“distributors”) who operate one or more retail locations, such as a store. Petitioner provides distributors with card inventory, marketing materials, and IT functionality at the point of sale. Petitioner also manages all aspects of the prepaid debit card program, including overseeing the system of distributors, and cardholders.

Petitioner’s core products include general purpose reloadable cards (GPR), gift cards, and [REDACTED] ® 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. [REDACTED] ® 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. Petitioner’s prepaid debit cards give cardholders the ability to securely transact, both online, and offline, with merchants that accept payments through MasterCard International, Visa or Discover (“the Network Providers”) and at ATM networks with which the bank is affiliated. The cards do not include any credit card or other product that accesses credit. For purposes of this opinion, GPRs, gift cards, and [REDACTED] ® cards will be referred to as prepaid debit cards.

Petitioner derives income from fees charged in connection with the issuance and subsequent use of the prepaid debit cards. A card is issued for a set amount known as a fulfillment fee. The fulfillment fee, paid by the customer cardholder, is split between Petitioner, and the distributor (the merchant or store that physically holds the cards). Once money is loaded onto a card, various transactional fees are collected. These fees include interchange fees, as described below, monthly service fees, account maintenance fees, lost or stolen card fees, convenience fees, and balance inquiry fees. Petitioner 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 since systems have not been created to allow for such tracking.

Petitioner employs regional account managers, located in sixteen states, to solicit business from new distributors, and maintain relationships with existing distributors. The account managers educate and train the distributors' employees, set sales goals for the distributors, ensure that the distributors have the correct points of sale, and assist the distributors with the marketing of prepaid debit cards. Agreements between Petitioner, and distributors provide that distributors will act as independent agents: 1) to receive for delivery to Petitioner sign-up information, and applications for prepaid debit cards, 2) to deliver to the issuing bank activation fees for cards, and funds tendered by customers to distributors for the purpose of reloading cards, and 3) to offer its customers other services related to the prepaid debit cards.

Petitioner's corporate offices and headquarters are based in Austin, Texas, where a majority of its employees are located. These employees "process" the transactions and manage the debit cardholder's account data using Petitioner's proprietary processing software. Processing includes the activities necessary to issue a prepaid debit card and complete a transaction. Such activities include, but are not limited to: set up, activation, and maintenance of the card and cardholder funds, transaction authorization, processing, clearing, and settlement, system access, cardholder dispute resolution, system compliance, regulatory compliance, security and fraud control, and activity reporting. For example, when a purchase transaction takes place, an electronic notification is sent to Petitioner to alert Petitioner that a card holder made a purchase for a certain dollar amount. The Petitioner processes that transaction by 1) verifying the cardholder has sufficient funds in his or her account with the issuing bank to cover the purchase, and 2) sends a notification to the cardholder's issuing bank indicating funds should be released to the merchant.

Petitioner has the following sources of revenue:

1. Fulfillment fees – amounts received from the sale of prepaid debit cards.
2. Interchange fees - fees charged by the card-issuing bank to the merchant bank for processing the cardholder's purchase transaction at the merchant's establishment. The card-issuing bank deducts the interchange fee from the amount it pays the merchant bank when the merchant accepts a card using the Visa, and MasterCard network. The fee is usually a percentage of the transaction amount and is set by the credit card networks. Typically this fee is earned by the issuing bank, but since the issuing bank has engaged Petitioner to process transactions on its behalf, it has agreed to give 100% of the fee to Petitioner for processing the transactions. Petitioner and issuing bank agreed to this fee via a revenue share agreement for processing the prepaid debit card accounts.
3. Service Revenue – various fees for the maintenance and use of a debit cardholder's account. Petitioner charges cardholders various service fees associated with the maintenance and use of the outstanding cards. The fees include the following:

Service fees – a fee, charged each time the card is used by the customer, or a monthly service fee that allows for multiple transactions.

Account maintenance fees – Amount charged to a cardholder for each reloadable card with an inactive balance exceeding 90 days. Gift card accounts are charged an account maintenance fee for inactive account balances exceeding six months.

Lost or stolen card fees – fees to replace a lost or stolen card.

Balance inquiry fee – fee for inquiring into the balance of an account.

Account to account transfer – fee for transferring funds from one Petitioner cardholder account to another.

Check fee – charge for issuing a check to close an account.

Analysis

Paragraph (a) of subdivision three of section 210 of the Tax Law provides that the portion of a taxpayer's entire net income allocated to the State is determined in part by multiplying its business income by its business allocation percentage (BAP). The BAP consists entirely of the receipts factor (Tax Law § 210.3(a)(10)(A)(ii).)

Section 210.3(a)(2) of the Tax Law provides the rules for purposes of computing the receipts factor. The BAP is determined by dividing a taxpayer's New York business receipts by its total business receipts within and without New York. In general, receipts are placed into one of five categories for purposes of sourcing and allocation: 1) receipts from tangible personal property are sourced where delivered, 2) receipts from the sale of services are sourced to the place where performed, 3) receipts from rentals of real, and personal property are sourced to where the property is located, 4) royalties for the use of patents and copyrighted material are sourced to the place where used and 5) other business receipts are sourced to the place where earned.¹

In this case Petitioner's receipts are comprised of: 1) fulfillment fees from the sale of prepaid debit cards, 2) interchange fees for processing a cardholder's purchase transactions, and 3) fees arising from the maintenance, and use of the cardholder's account.

1. Fulfillment fees

Section 208.11 of the Tax Law provides that the term "tangible personal property" means corporeal personal property, such as machinery, tools, implements, goods, wares, and merchandise and does not mean money, deposits in banks, shares of stock, bonds, notes, credits or evidences of an interest in property and evidences of debt. In *Deloitte & Touche*, Adv Op Comm T&F, April 18, 2002, TSB-A-02-(3)C, it was concluded that merchant certificates, taxpayer certificates and gift checks that a taxpayer sold to customers over taxpayer's website were intangible property because the underlying value of that property represented the intangible right to redeem it for property or services at some future time. In this case, the prepaid debit cards sold by Petitioner also represent a purchaser's right to redeem, at some future time, property or services with merchants that accept payment through the electronic network providers. Therefore, the fulfillment fees received from the sale of prepaid debit cards are not receipts from the sale of tangible personal property, services, rentals of real, and personal property or royalties for the use of patents, and copyrighted material. The fulfillment fees are classified as "other business receipts" under the business allocation provisions of the Tax Law, and will be allocated to New York according to the place where they are earned.

In this case, the fulfillment fees are earned when the prepaid debit cards are sold to a customer. Therefore, the fulfillment fees will be considered to be earned in New York when the prepaid debit cards are sold to a customer at a New York establishment. Thus, if a distributor sells a prepaid debit card to a customer at its New York retail store, the receipt from that sale will be allocated to New York.

¹ Section 210 also includes rules for specific types of receipts, such as brokerage commissions, that are not relevant here.

Additionally, Petitioner has submitted information that indicates that the prepaid debit cards are also sold to customers through Petitioner's website. In *Deloitte*, it was decided that receipts from merchant certificates, taxpayer certificates, and gift checks are derived from the activity of the customer that accesses the Internet to purchase taxpayer's products from its Web site, and those receipts would be sourced to New York if the location where the customer accesses the website is located in New York. *Deloitte* also held that, where information is not available to determine the location of the customer's equipment used to draw upon the taxpayer's databases, the location will be presumed to be at the customer's mailing address. That opinion is instructive in this case, and leads to the conclusion that receipts from Petitioner's prepaid debit cards sold over the Internet through Petitioner's website will be allocated to New York if the location where the customer accesses Petitioner's website is located in New York. If the information to determine the location of the customer's equipment that accesses Petitioner's website is not available to Petitioner, then the location will be determined in accordance with the customer's billing address.

2. Interchange fees

Petitioner has agreements with issuing banks to receive all of the issuing banks' interchange fees in exchange for performing each of the issuing banks' processing activities necessary to issue the banks' debit cards and process cardholder transactions. The processing activities include, but are not limited to: set up, activation and maintenance of the card, and cardholder funds, transaction authorization, processing, clearing and settlement, system access, cardholder dispute resolution, system compliance, regulatory compliance, security, and fraud control, and activity reporting.

In *New York Mercantile Exchange*, Adv Op Comm T&F, April 7, 1999, TSB-A-99(16)C (*NYMEX*), the taxpayer (*NYMEX*) received subscription fees from vendors who were granted a license to electronically access *NYMEX*'s market data. The Department concluded in that case that the subscription fees were other business receipts, and should be sourced to where they were earned; that is, to the location where *NYMEX* delivered the data to the vendors. Delivery took place at the location that the vendor used to draw upon the market data obtained under the license arrangement with the taxpayer. Similarly, in *Insurance Services Offices, Inc.*, Adv Op Comm T&F, September 6, 2000, TSB-A-00(15)C, subscription fees for electronic access to copyrighted data, forms, and other material were found to be other business receipts. As in *NYMEX*, the fees were sourced to the location of the customers' computer equipment and modems (or if the location was unknown, then presumptively to the customer's mailing address). The *NYMEX*, and *Insurance Services* opinions show that the subscription fees or similar charges that give the customer the ability to electronically receive information from a taxpayer, or from a taxpayer's database, will be considered other business receipts.

Although not dictating the conclusion, *NYMEX*, and *Insurance Services* are instructive. Like the subscription fees in *NYMEX*, and *Insurance Services*, the revenue Petitioner receives from issuing banks for the electronic processing of issuing banks' transactions with cardholders constitutes "other business receipts" for purposes of the receipts factor of the business allocation percentage under section 210.3(a)(2) of the Tax Law. Therefore, such receipts are considered New York receipts to the extent that they are earned in New York. Neither Article 9-A of the Tax Law nor the Business Corporation Franchise Tax Regulations provide specific guidance on where receipts of the types at issue in this case are "earned."

However, Article 32 of the Tax Law, which imposes a franchise tax on banking corporations, does provide guidance in the case of sourcing receipts from certain banking activities. Tax Law § 1454(a)(2)(D) provides the allocation rules for banking corporations from bank and credit card receivables. That section provides that interest and fees in the nature of interest from bank, and credit cards are earned within the state if the mailing address of the cardholder is in the state. That section also addresses receipts from merchant discounts. A merchant discount is a fee charged by an issuing bank to a merchant for processing bank credit

card sales and crediting the funds to the merchant's account. Receipts from merchant discounts are allocated to New York if the merchant is located in New York. Like a banking corporation's receipts, Petitioner's receipts are earned from an issuing bank in exchange for processing the issuing bank's transactions with its cardholders. Therefore, it is appropriate in this case for Petitioner to source the fees it receives from an issuing bank to New York using a method similar to that used by a banking corporation in allocating its receipts under Tax Law § 1454(a)(2)(D). That is, the portion of the receipts Petitioner earns for processing activities of an issuing bank with respect to a New York merchant will be sourced to New York. However, if it cannot be determined whether the cardholder transaction occurred with a New York merchant, or the fee is considered more like a service charge or fee, and is not a fee for processing a transaction with a merchant, then the receipt will be considered earned in New York if the cardholder's mailing address is in New York State.

Peach Tree Bancard Corporation, Adv Op Comm T&F, August 4, 1995, TSB-A-95(13)C, no longer reflects the Department's position on this subject. There, the Department concluded that a taxpayer's credit card processing fees were receipts from services, and those receipts would be allocated to New York if the services were performed in New York. The opinion also indicated that, unlike § 1454(a)(2)(D) of Article 32 of the Tax Law, which provides a special rule for allocating receipts from merchant discounts to where the merchant is located, Article 9-A has no special rule for determining receipts from credit card processing activities for purposes of computing the receipts factor of the business allocation percentage. Neither the conclusion in *Peach Tree* nor the rationale remains valid.

3. Maintenance and Use Revenue

Petitioner's fees from maintenance, and use revenue represents the various fees charged to the prepaid debit cardholder for maintaining, and using the prepaid debit card, and responding to cardholder reports, and inquiries. This includes a monthly service fee, account maintenance fee, lost or stolen card fee, convenience fee, and a balance inquiry fee. These fees are generally incurred each time a customer initiates a transaction.

Like the processing activities described above that Petitioner performs for the issuing bank, the processing activities Petitioner performs for the cardholders are also considered other business receipts, and will be sourced based on where they are earned. In this case, it is appropriate to allocate those receipts based on where the customer initiates a transaction. Therefore, if customer reloads its prepaid debit card at a New York establishment, then that fee will be considered to be earned in New York. In cases where it cannot be determined where the transaction is initiated by the cardholder, then the receipt will be considered earned in New York if the cardholder's mailing address is in New York State.

DATED: December 28, 2010

/S/

DANIEL SMIRLOCK
Deputy Commissioner and Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.