REQUEST September 7, 2005

NAME
ADDRESS

Request for Ruling
September 7, 2005

Dear TP REPRESENTATIVE,

We are requesting a ruling from the Utah State Tax Commission as to the application of Utah's corporate franchise tax apportionment rules to financial institution doing business in Utah. Please find attached a Memorandum in Support of Ruling Request, which provides relevant facts, sets forth the issue upon which we are requesting that the Commission rule, and a detailed analysis of applicable laws, regulations and other guidance in support of what we believe to be the correct conclusion. We are submitting this ruling request on a "no-name basis, subject to receipt of a favorable ruling.

It is our understanding that this request will be assigned to a Commission reviewer. Once it has been assigned, we ask that the reviewer contract me at PHONE NUMBER or my colleague, OTHER NAME, at OTHER PHONE NUMBER, so that we can discuss the procedures, any concerns and timing for obtaining the rule.

Your attention to this matter is greatly appreciated.

Sincerely,

NAME

Memorandum In Support of Ruling Request

September 7, 2005

I. Facts:

The applicant is organized in a parent-subsidiary structure (hereafter referred to as "Parent," "Subsidiary" and, collectively, "Taxpayers"). Subsidiary is a financial services business that does business in Utah and also has several employees in States X and Y. Subsidiary issues credit cards to individuals who reside in every state in the United States plus the District of Columbia. Subsidiary's number of credit card holders in a given state ranges from a maximum of approximately $$$$$$ to a minimum of approximately $$$$$$.

Subsidiary earns: (1) interest income and fees, such as late fees, cash advance fees, return check fees, over-limit fees, pay-by-phone fees and annual fees from its credit card holders (collectively, "Credit Card Income"); [1] (2) interchange fees ("Interchange Fees") from banks that contract with merchants where the banks agree to pay Subsidiary (i.e., the issuer) a fee based on credit card charges made by Subsidiary's credit card holders; and (3) interest from installment loans made to individuals for the purchase of personal property ("Loan Interest").

Parent does business in multiple states. Parent services credit cards issued by Subsidiary and unrelated third parties. As part of its credit card serving function, Parent is required to register as a debt collector in all 50 States, which, in turn, requires Parent to register to do business in all such states. In addition, Parent files tax returns in many of the states in which it is registered.

It is assumed for purposes of this ruling request that:

1. Taxpayers are corporations for federal income and Utah corporation franchise tax purposes.
2. Taxpayers are members of a unitary group pursuant to Title 59, Chapter 7 of the Utah Code Annotated ("Code" or the" Code") and file as such for Utah franchise tax purposes.
3. Subsidiary is a "financial institution" pursuant to R865-6F-32.A.8 of the Utah Administrative Code {"regulation") and is "commercially domiciled" in Utah pursuant to regulation R865-6F-32.A.3. Other than the employees located in States X and Y, Subsidiary does not have property (other than credit card holders or re-possessed property) or employees in any other state.

[1] Please refer to the "Definitions" attachment

4. Parent is not a "financial institution" pursuant to the above-referenced provision and does not, for Utah franchise tax purposes, have taxable nexus with Utah.

5. The Credit Card Income, Interchange Fees and Loan Interest are business income for purposes of regulation R865-6F-32.B.2.

II. Issue:

For Utah Corporation franchise tax apportionment purposes, what portion of Subsidiary's receipts from Credit Card Income, Interchange Fees and Loan Interest should be included in the numerator of Taxpayers' receipts factor (i.e., sourced to Utah?

III. Law and Analysis:

In general, where a taxpayer engages in business in Utah and other states, there are allocation and apportionment rules that apply to the taxpayer's taxable income base. Code section 59-7-303(1) provides that taxpayers having income from business activities taxable both within and without Utah must allocate and apportion their income according to Title 59, Chapter 7, Part 3 of the Code. For this purpose, Code section 59-7-305(2) provides that a taxpayer is taxable in another state if "that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does to does not."[2]

Taxable income is allocated or apportioned depending on the type of income involved. In this regard, taxable income is bifurcated between "business income" and "non-business income." Code section 59-7-302(1) provides that business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." Code section 59-7-302(4) provides that non-business income is all income other than business income.

In general, business income is subject to apportionment and non-business income is subject to separate set of allocation rules.[3] Code section 59-7-311 provides that business income must be apportioned to Utah by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.[4]

[2]The term "state" includes any state of the United States and the Districts of Columbia. Code section 59-7-302(6).

[3]This ruling request is concerned only with business income. Accordingly, the allocation of non-business income is not addressed.

[4]For tax years beginning on or after January 1, 2006, taxpayers may elect of double-weight the sales factor. See UT HB 78, section 1, which amends Code section 59-7-311 to provide for the election.

For purposes of the apportionment formula, Code section 59-7-317 provides that the "sales factor" is a fraction, the numerator of which is the taxpayer's total sales in Utah, and the denominator of which is the taxpayer's total sales everywhere. In this context, Code section 59-7-302(5) provides that "sales" means all gross receipts of the taxpayer not allocated under Sections 59-7-306 through 59-7-310 (which apply to non-business income).

A taxpayer's gross receipts are sourced to Utah (or not) depending on the type of activity in which a taxpayer is engaged. Gross receipts for sales other than sales of tangible personal property (i.e., receipts for services performed) generally are sourced based on the "cost of performance rule. Code section 59-7-319 provides that such receipts are sourced to Utah if the income-producing activity is performed in Utah, or the income-producing activity is performed both in and outside Utah and a greater proportion of the income-producing activity is performed in Utah than in any other state, based on costs of performance. Thus, under the cost of performance rule, a service provider that performed services with and without the State would source all of its gross receipts to Utah for apportionment purposes to the extent the greater portion of its income producing activities (based on cost) takes place in Utah.

There are, however, special allocation and apportionment rules for the financial services industry that apply in lieu of the foregoing general apportionment rules. Regulation R865-6F-32B.1 provides that a financial institution (as defined in regulation R865-6F-32A.8) whose business activity is "taxable" within the without Utah must allocate and apportion its net income as provided in regulation R865-6F-32B. As with the general rule cited above, regulation R865-6F-32A.20(b) provides that "taxable" means another state has the jurisdiction to subject the taxpayer to taxes regardless of whether the state actually imposes such taxes.

As with the general apportionment rules, regulation R865-6F-32B.2 provides that business income of a financial institution is apportioned pursuant to a formula consisting of the same three factors cited above – receipts, property and payroll[5] These factor rules, however, are specific to activities performed by financial providers, several of which are relevant to this ruling request.

First, regulation R865-6F-32.C.7 provides that receipts from "credit card receivables," which include "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" are sourced to the billing address of the cardholer.[6] Thus, if a cardholder's billing address is not in Utah, the numerator of the receipts factor would not include the credit card receipts from such cardholder.

[5] At the time of this writing, the Utah Tax Commission has not, to our knowledge, promulgated amended regulations to take into account the double-weighted sales factor election.

[6] For purposes of these rules, "credit card" means a credit, travel or entertainment card. Regulation R865-6F-32A.5

Second, regulation R865-6F-32C.9 provides that "credit card issuer's reimbursement fees" are sourced to Utah by multiplying the amount of such fees by a fraction, the numerator of which is the amount of credit card receivables sourced to Utah and the denominator of which is total amount of credit card receivables. Pursuant to R865-6F-32.A.6, credit card issuer's reimbursement fees are the fees a taxpayer receives from a merchant bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise of services to the credit card.

Third, regulation R865-6F-32.C.5 provides that "interest from loans not secured by real property" includes interest and fees or penalties in the nature of interest from borrowers located in Utah. A "loan" for this purpose means any extension of credit resulting from direct negotiations between a taxpayer and its customer. Thus, as with credit card receivables, if a borrower's address is not in Utah, the numerator of the receipts factor would not include interest receipts from such borrower.

The foregoing rules do not necessarily apply to all members of a combined group of corporations. Regulation R865-6F-32.4 provides that where a unitary group of corporations filing a combined report consists of financial institutions and non-financial institutions, the special apportionment rules, described above, apply on to the financial institutions. The remainder of the corporations in the group (assuming they are not in another special industry) would use the general allocation and apportionment rules.

In summary, the apportionment rules generally permit a financial institution doing business within and without Utah to source receipts from credit card receivables, credit car issuer's reimbursement fees and interest form loans not secured by real property to the billing address of the credit card holders. There is, however, an exception to these "customer sourcing" rules where the financial institution is commercially domiciled in Utah but where it is not taxable in other states.

Regulation R865-6F-32.C.15(a) provides that "all receipts assigned ... to a state in which the taxpayer is not taxable shall be included in the numerator of the receipts factor if the taxpayer's commercial domicile is in this state" (hereafter referred to as the "throwback rule").[7] For this purpose regulation R865-6F-32A.20 provides , in part, that "taxable" means" another state has the jurisdiction to subject the taxpayer to taxes regardless of whether that state actually imposes those taxes."

[7]For this purpose, regulation section R865-6F-32.A.3 provides that "commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

The regulations provide for two exceptions to the throwback rule. Presumably, these exceptions are intended to incorporate the "Finnigan" rule. As briefly discussed below, the Finnigan rule originated from a line of California cases that addressed the application of California's throwback rule in the context of a unitary group or corporations.

In *Appeal of Finnigan*,[8] two corporations, one with California nexus, one without, filed a unitary return. The corporation without nexus sold goods to customers located in states in which it was not subject to tax; however, the unitary affiliate was subject to tax in such states. At issue was whether California's throwback rule would apply since the selling corporation was not subject to tax in the destination states. The tax tribunal determined that the throwback rule would not apply because, although the seller was not subject to tax in the destination states, its unitary affiliate was taxable. The tribunal thus viewed the unitary group as one taxpayer for purposes of applying the throwback rule.

With the foregoing principal in mind, regulation R865-6F-32.C.15(b) provides the following two exceptions to the throwback rule:

1. If a unitary group includes one or more financial institution, and if any member of the unitary group is subject to the taxing jurisdiction of this state, the receipts of each financial institution in the unitary group shall be included in the numerator of this state's receipts factor as provided in C.1. through C.14. [which include the customer sourcing rules noted above] rather than being attributed to the commercial domicile of the financial institution as provided in C.15.a).
2. If a unitary group includes one or more financial institutions whose commercial domicile is in this state, and if any member of the unitary group is taxable in another state under section 59-7-305, the receipts of each financial institution in the unitary group that would be included in the numerator of the other state's receipts factor under C.1. through C.14 [which include the customer sourcing rules noted above] may not be included in the numerator of this state's receipts factor.

The first exception (1) presumably is directed at a financial institution within a Utah unitary group that is commercially domiciled outside of Utah (it would not otherwise make sense, when read in the context of the second exception). Employing the *Finnigan* principle, it provides that even though a non-commercially domiciled financial institution does not have nexus with Utah, as long as a unitary affiliate does, such financial institution may not throw its receipts back to its commercial domicile; rather, it should

[8]Cal State Bd. Of Equiliz., August 28, 1988, Dkt. No. 88-SBE-022, *on reh'g*, Jan 24, 1990 (referred to as *Finnigan I and Finnigan II).* CF, There also is the *Joyce* rule, which is another line of California cases that came to the opposite conclusion of *Finnigan* (i.e., a unitary affiliate that has nexus with a state will not impact a selling corporation that does not have nexus).

continue to source based on the regular sourcing rules (which include customer sourcing in C1. to C.14.). This ensures, for example, that if the financial institution had credit card holders residing in Utah, income earned from such persons would be included in the unitary group's Utah numerator.

The second exception (2), which is directed at a financial institution that is commercially domiciled in Utah, virtually encapsulates the basic facts and premise of *Finnigan.* It provides that, to the extent a unitary affiliate (of a financial institution that is commercially domiciled in Utah) is "taxable" in another state, the throwback rule does not apply to such financial institution. Code section 59-7-305 provides that a taxpayer is taxable in another state if "that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not."

It is the second exception that is applicable for purposes of this ruling request. In this regard, the throwback rule would not apply to a financial institution that is commercially domiciled in Utah where, at least, a unitary affiliate is registered to do business in every state (and, thus, "taxable" in other states and, where necessary, filing tax returns in such states)[9] and where the financial institution has credit card holders in every state. Accordingly, such financial institution would be subject to the receipts sourcing rules contained in regulation section R865-6F-32.C.1. through C.14, which include customer sourcing for credit card receivables, interchange fees and interest from loans not secured by real property.

IV. Ruling Requested:

Based on the foregoing, Taxpayers' income would be subject to apportionment because Subsidiary is doing business in Utah and is subject to tax in other states (and, though not critical is filing a return in States X and Y), as is Parent. The apportionment rules applicable to financial institutions would apply to Taxpayers because Subsidiary is a financial institution that is commercially domiciled in Utah within the meaning of regulation section R865-6F-32.A.8 and R865-6F-32.A.3. For this purpose, the Credit Card Income earned by Subsidiary is a "credit card receivable" because such income consists of interest and penalties and fees from credit cards issued by Subsidiary; the Interchange Fee is a "credit card issuer's reimbursement fee" because it is a fee earned by Subsidiary with respect to charges made by its cardholders to merchants who contract with other banks for reimbursements; and the Loan Interest is "interest from loans not secured by real property." Utah's throwback rule does not apply to Subsidiary because Subsidiary is "taxable" in those states in which cardholders reside (it also files returns in certain states) and Parent, its unitary affiliate, is "taxable" in all states in which it is registered both as a debt collector and to do business (and files tax returns therein) (i.e., Taxpayers are taxable in all 50 states plus the District of Columbia).

[9]The vast majority of the states require taxpayers that are merely registered to do business in such states to file a return.

Accordingly:

1. Only Credit Card Income collected from cardholders with billing addresses in Utah must be included in the numerator of Taxpayers' receipts factor;
2. Only a *pro rata* portion of Interchange Fees, based on a ratio of Taxpayers' Credit Card Income sourced to Utah over Taxpayers' total Credit Card Income, must be included in the numerator of Taxpayers' receipts factor; and
3. Only Loan Interest received from borrowers located in Utah must be included in the numerator of Taxpayers' receipts factor.

DEFINITIONS

Annual Fee – Annual or monthly fees that are assessed to the credit card accounts that are either open or closed with a balance. The fee amount varies depending on the pricing strategy offered to the cardholder.

Cash Advance Fee – A fee is assessed if a cardholder chooses to withdraw cash against his/her credit account. This fee is calculated as a percentage of the transaction or as a flat minimum, whichever is greater.

Return Check Fee – A fee is assessed when a cardholder's payment is returned unpaid by their financial institution.

Over-limit Fee – A fee is assessed when a cardholder's account balance exceeds his/her credit limit.

Pay-by Phone Fee – This fee is assessed to a cardholder for the ability to make a payment to his/her credit card account over the telephone.

RESPONSE

July 26, 2006

NAME
ADDRESS

RE: Application of Corporate Franchise Tax Apportionment

Dear NAME,

We are in receipt of your request for a ruling as to the application of Utah's corporate franchise tax apportionment rules to your client. Based on the information you provided, and as discussed in greater detail below, we understand your client is an incorporated financial services business doing business in Utah, and having several employees in two other states. The financial services business is a subsidiary of a parent company. The subsidiary issues credit cards to individuals residing in the fifty states and the District of Columbia. It derives income from three sources: interest and fees; interchange fees; and, interest from installment loans.

The parent company does business in multiple states. It services the credit cards issued by the subsidiary and unrelated third parties. Because it collects debts in all fifty states, it is registered to do business in all fifty states. It also files tax returns in many of those states.

Both are corporations for federal income and Utah corporate franchise tax purposes. They are members of a unitary group under Title 59, Chapter 7 of the Utah Code Annotated. The subsidiary is a financial institution under R865-6F-32 (A)(8). It is "commercially domiciled" in Utah under R865-6F-32 (A)(3). The parent is not a financial institution under those provisions and you have represented it does not have taxable nexus to Utah for franchise tax purposes.

We have reviewed your request for a specific ruling regarding certain provisions of Utah Administrative Rule R865-6F-32. These provisions deal with whether certain income should be "thrown back" to Utah as Commercial Domicile within the context of a unitary business and applying Utah rule provisions similar to 'Finnigan'. The Finnigan approach to determining tax liability in Utah is based on whether any member of the unitary group of the corporation has a sufficient nexus with Utah.

As you noted, there were two Finnigan decisions. The issue in Finnigan I was application of the throw back rule. As explained in Finnigan I, the general rule is that sales of tangible personal property are assigned to the state of destination of the goods for purposes of the sales factor of the apportionment formula. The throw back rule applies when property is shipped from State "A" to State "B" and the taxpayer is not taxable in

State “B.” The result in Finnigan I was that the affiliate's sales to foreign states were not thrown back to California because a member of the unitary group was taxable in the foreign state.

We point out that one paragraph in your request letter misquoted the above rule with respect to the sourcing of ‘credit card issuer’s reimbursement fees’. Your letter indicated that the rule provides that credit card issuer’s reimbursement fees are sourced to Utah by multiplying the amount of such fees by a fraction, the numerator of which is the amount of credit card receivables sourced to Utah and denominator of which is total amount of credit card receivables. Utah Administrative “Rule R865-6F-32(C)(9) actually provides that the numerator of the receipts factor includes all credit card issuer’s reimbursement fees multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to C(7) [1] and the denominator of which is the taxpayer’s total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders. Thus credit card issuer’s reimbursement fees are sourced using the same ratio that credit card interest and fees attributable to cardholders in this state bear to credit card interest and fees everywhere.

We understand the essence of your question to be whether the ‘Finnigan’ language within the Utah Financial Institutions Rule serves to negate the throwback provisions within the same rule based upon a factual determination in the scenario you have outlined, that either (i) the parent corporation has nexus in every state by virtue of having to register as a debt collector in all 50 states, or (ii) the subsidiary has nexus in every state because it has credit card holders that exceed a de minimis level in every state.

We agree with your conclusion that receipts from credit card income, interchange fees and loan interest from loans not secured by real property, to the extent the cardholders address or borrower is not in Utah is not required to be thrown back if any member of the unitary group is taxable in each of the states to which such receipts would otherwise be assigned under applicable Utah administrative rules.

Therefore, it is necessary to examine the facts associated with both the parent and the subsidiary in order to make a determination as to whether under the facts presented, nexus would be created in all states. You have indicated that the parent corporation as a debt collector is required to register in all 50 states. However, a corporation that is merely registered to do business in a state cannot be subjected to a state income or franchise tax (other than a minimum tax) if its activities either do not exceed the limitations of Public Law 86-272 or constitutional requirements governing those activities performed by a corporation that give a state the right to impose its tax. Therefore, the mere registration to do business in a state by the parent corporation may

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1 Note that this paragraph generally requires that interest and fees from credit card receivables and fees charged to cardholders be sourced to this state if the billing address of the cardholder is in this state.

not create nexus unless the parent corporation engages in business activities in every state that exceed the above thresholds.

We do not know the nature of the business of the parent and, accordingly, do not know if it is protected from tax under Public Law 86-272. If it is so protected in any state, or if the parent takes the position in any state that its income is not "taxable" in that state, we would expect the receipts attributable to that state to be "thrown back" to Utah, unless the subsidiary is taxable in that state.

You indicate that the subsidiary is a financial institution with credit card holders in every state ranging from 1,200 to 110,000 cardholders. It is clear that the subsidiary is targeting the market of every state and is therefore 'doing business' or 'deriving income' from within every state. Since the number of credit card holders in the state where the least amount of operations conducted is 1,200, a level we would consider beyond de minimis, we conclude that the subsidiary is conducting business in every state. Because the subsidiary is doing business in every state, no throwback to Utah as commercial domicile is required for interest and fees from credit card operations or interest from loans not secured by real property. Since Interchange Fees are sourced using the ratio of credit card income in Utah to credit card income everywhere, such fees would likewise not be required to be thrown back.

This decision is based on your representations that the subsidiary is actually taxable in every state in which it has credit card holders. To the extent that another state's law concludes that the presence of cardholders in that state is not sufficient to make the subsidiary's income subject to tax, however, the throwback rule could apply. See, e.g., *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831, 840 (Tenn. Ct. App. 1999), holding that an out-of-state bank was not "taxable" in Tennessee, even though it had between 11,000 and 17,000 cardholders in that state. Thus, if the subsidiary were to take the position that it is not "taxable" in any particular state under such reasoning, we would expect the receipts from that state to be thrown back to Utah.

We therefore, agree with the three conclusions listed in your summary based on the facts presented in your ruling request as follows:

Only credit card income collected from cardholders with billing addresses in Utah must be included in the numerator of taxpayer's receipts factor;
Only a portion of interchange fees, based on a ratio of taxpayers' total credit card income, must be included in the numerator of taxpayers' receipts factor; and
Only loan interest received from borrowers located in Utah must be included in the numerator of the taxpayers' receipts factor.

Should the facts be different from those represented in this letter, or if the parent or the subsidiary was to take a filing position in any other state that it was not "taxable" in that state, our opinion may change accordingly. Thank you for your inquiry into this matter.

For the Commission,

R. Bruce Johnson
Commissioner

RBJ/SR
05-011