



Bailey Cavalieri LLC
ATTORNEYS AT LAW

CLIENT ALERT

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Gift Card Law Updates January 2012

Recent legislative action in the State of Washington and the People's Republic of China has implications for retail gift card issuers. This Client Alert summarizes the recent legislative action in both jurisdictions.

Washington Department of Revenue Ruling 10-0057 – Nexus of Mail Order Retailer with Washington Related to Gift Card Sales of Affiliate

Under Washington law, businesses that have “substantial nexus” with the State of Washington are required to pay a business and occupation tax (“B&O Tax”) and retail sales tax sales. At issue in Department of Revenue Ruling 10-0057 (the “Decision”), was a B&O tax assessment against a mail order retailer (the “Direct Retailer”) who was located outside the State of Washington, but sold gift cards and provided customer service assistance through an in-state, retail store affiliate (the “Affiliate”). The Washington Department of Revenue (“DOR”) determined that the Affiliate’s activities were significantly associated with the Direct Retailer’s ability to establish and maintain a market in Washington and therefore created a nexus.

WAC § 458-20-193 imposes the B&O Tax on sales of goods which originate outside of the state but are purchased in state from an entity who has “nexus” with the state. For direct retailers, “nexus” is defined by the regulation to include instances when the “seller has a branch office [in the state] . . . utilized in any way such as receiving the order, franchise or credit investigation, or distribution of the goods.” The B&O Tax also applies to an out-of-state entity that directly or indirectly “performs significant services in relation to establishment and maintenance of sales into the state . . .”

In this instance, the Direct Retailer is a seller of supplies by mail order catalog. The Affiliate is a wholly-owned subsidiary of the Direct Retailer that owns and operates the catalog orders and the sales, while the Direct Retailer provided executive management, financial services, management of the gift card program and advertising services to the Affiliate. The Affiliate operates two retail stores in Washington State. The Affiliate sells gift cards at its Washington retail stores that can be redeemed by mail order, online or at retail locations by the Direct Retailer. When gift cards were sold, the cash was received by the Affiliate but then the cash and the liability for the gift card sold was transferred via an intercompany transaction to the Direct Retailer. Upon redemption of the gift card, the intercompany liability on the financial records of the Direct Retailer was relieved, with the sales recorded on the financial records of the Affiliate.

According to the DOR, the sole issue in the inquiry is whether the Direct Retailer, through the activities of the Affiliate, can be deemed to have “nexus” with the State of Washington. The DOR determined that the Affiliate’s activities of operating retail locations and performing other tasks were directly

related to the Direct Retailer's ability to establish and maintain a market in Washington for its sales. The DOR deemed the Affiliate's activities on behalf of the Direct Retailer as "facilitating or making" sales on behalf of the Direct Retailer. The DOR concluded that the Affiliate's activity of selling gift cards to Washington residents from retail locations in Washington which can be redeemed by mail order was sufficient to establish the Direct Retailer's "nexus" with Washington.

This Decision is significant for direct retailers that have a presence in Washington limited to the sale of gift cards by subsidiaries or affiliates that operate retail locations in Washington. The Decision makes it clear that the sale of gift cards alone by an affiliate or subsidiary is sufficient to create the direct retailer's nexus with Washington under applicable law and thus subject the direct retailer to payment of the B&O Tax and other business taxes.

The People's Republic of China's Draft Rules on Prepaid Cards

The Chinese commercial prepaid card market has grown rapidly in recent years as a popular alternative to cash gifts. Unfortunately, prepaid cards have also been tied to money laundering, corruption and tax evasion. The Chinese government, through its Ministry of Commerce ("MOC"), in December of 2011, released its draft *Rules on the Administration of Single Use Commercial Prepaid Cards* (the "Rules") for public comment. The Rules impose significant compliance obligations on gift card issuers.

The Rules define "single use commercial prepaid cards" as "vouchers for the purchase of goods and services of issuing commercial enterprises or retail chains." We believe the intent of the MOC in fashioning such a broad definition of "single use commercial prepaid cards" in the Rules was to cover all types of prepaid cards, including traditional closed-loop retail gift cards. Excluded from the scope of the Rules are prepaid cards valued at less than RMB200 (US \$32). The draft Rules impose the following registration, payment and record-keeping requirements on gift card issuers:

- **Registration Requirement** – Prepaid card issuers must record the names of purchasers of a gift card if they purchase cards that have an aggregate value of RMB10,000 (US \$1,580).
- **Restriction on Cash Purchases** – Corporate purchases of prepaid cards valued at RMB5000 (US \$790) and individual purchases valued at RMB50,000 (US \$7,900) may be made only by bank transfer (not cash) and the purchaser's bank account number must be registered.
- **Record-Keeping Requirement** – Prepaid card issuers must maintain records of the information collected as required by the Rules for a minimum of five (5) years.
- **Limits on Prepaid Card Value** – The values of branded prepaid cards are capped at RMB5000 (US \$790), while the value of a generic prepaid card is limited to RMB1000 (US \$160).

The issuance of the draft Rules demonstrates the MOC's commitment to regulating the prepaid card industry and making it more difficult for would-be criminals to take advantage of it for criminal purposes. While it is notable the draft Rules are not currently part of the law and remain subject to public comment and revision, if the draft Rules are adopted, they will impose significant obligations on the prepaid card business and prepaid card issuers in general. Therefore, prepaid card issuers that conduct business in China must closely monitor the progress of this legislation and begin making preparations to comply with the Rules when effective. We will continue to monitor the progress of these Rules and update you when new information becomes available.

If you have any questions or would like to discuss the legislation summarized in this memorandum in more detail, please do not hesitate to contact us.

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