

M e m o r a n d u m**120.0665****To :** AB - Torrance
Auditing (DMT)**Date:** May 13, 1993**From :** Elizabeth Abreu
Tax Counsel**Subject:** I--- P--- C---, Inc.
SR -- XX-XXXXXX

This is in response to your memorandum dated March 25, 1993 regarding the above-named taxpayer.

According to your memorandum, the taxpayer manufactures and sells credit cards such as Mastercard and Visa to financial institutions. The financial institution provides the taxpayer with a magnetic tape containing the information to be embossed on the credit cards. A code-encoder embosser reads the information on this tape. We assume that either this machine or another machine uses the information read from the tape to emboss the credit cards.

Occasionally a customer provides a tape that is not readable by the taxpayer's equipment. For example, information from several bank branches are consolidated on a single tape which cannot be read by the card-encoder embosser. The taxpayer transfers the information on this tape to four different tapes which can be read by the embosser. The taxpayer makes a separate charge for this procedure which it identifies as "interim tape processing." The taxpayer asserts that the charges for producing the readable tapes are not taxable because original information, i.e., the readable input, is developed during the process.

The taxpayer is referring to Regulation 1502(d)(5) which explains the application of tax to processing of customer furnished information. Subparagraph C of this subsection provides that where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendition of a service. Generally, tax does not apply to the charges made under contracts providing for the transfer of the original information.

This regulation does not apply to the transactions in issue because the financial institutions have not contracted for the taxpayer to process customer-furnished information and to provide original information. Rather, the financial institutions have contracted to purchase credit cards from the taxpayer. The transfer of the information from one tape to another tape is just one step in the manufacturing process of the credit cards. Regulation 1524(a) specifically provides:

“IN GENERAL. Tax applies to the gross receipts from retail sales (i.e., sales to consumers) by manufacturers of tangible personal property the sale of which is not otherwise exempted. The measure of the tax is the gross receipts of, or sales price charged by, the manufacturer, from which no deduction may be taken by the manufacturer on account of the cost of the raw material or other components purchased, or labor or service costs of any step in the manufacturing process, including work performed to fit the customer’s specific requirements, whether or not performed at the customer’s specific request, or any other services that are a part of the sale. In addition, no deduction may be taken on account of interest paid, losses or any other expense.”

Thus, the taxpayer may neither exclude nor deduct the interim tape processing charge.

EA:cl

cc: Torrance District Administrator