

**BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA**

TRACFONE WIRELESS, INC.

Appellant,

vs.

DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA,

Respondent.

Cause No.: MT-2009-3

**FINDINGS OF FACT,
CONCLUSIONS OF LAW &
ORDER**

TracFone Wireless, Inc. (“TracFone”) moved the Board for summary judgment in its favor reversing the Department of Revenue’s (“Department”) deficiency assessment at issue in this matter. The Board upholds TracFone’s motion for summary judgment and reverses the Department’s assessment of the relevant tax years.

UNDISPUTED FACTS

TracFone appealed from the Department’s deficiency assessment for additional Retail Telecommunications Excise Tax (“RTET”) for the periods from fourth quarter of 2004 through first quarter of 2009 (the “Audit Period”).

The facts below are based on those presented in TracFone’s motion for summary judgment and undisputed by the DOR. TracFone is a reseller of wireless telecommunication services. TracFone contracts with licensed wireless carriers throughout the United States to resell wireless service to consumers who purchase TracFone prepaid airtime, units or minutes (collectively “Airtime”). TracFone has been doing business since 1996.

TracFone’s products consist of handsets or devices, and prepaid airtime. TracFone’s handsets each contain proprietary software commonly referred to as a prepaid engine, which allows TracFone’s business to function. TracFone is a non-

facilities based reseller with no network or switches. The handset software tracks the usage of airtime and limits the handset's access to carrier networks when a handset's loaded airtime has been exhausted. Each user must go through a process to activate his or her handset upon purchase. This activation process requires the user to provide TracFone the zip code of the area where the handset will be primarily used. TracFone retains this information in its systems, and uses it when TracFone assigns a phone number to a particular handset. This original information is referred to as the "Activation zip code."

Each handset is shipped with a nominal amount of airtime pre-loaded to facilitate the activation process. A user must, however, purchase additional airtime to use the handset normally. TracFone sells its wireless airtime on a prepaid basis, either through third-party retailers, or directly¹ from TracFone.

In the transactions involving third-party retailers ("Wholesale Transactions"), TracFone sells a certain amount of Airtime to retailers or distributors, who then resell to other retailers. The retailer then sells the Airtime PIN Code or PIN number (collectively "PIN Code") to its customer as a preprinted TracFone branded card or as a document printed by the retailer (collectively "Prepaid Card"). No RTET is collected by the retailer at the point of sale.

For security and fraud protection purposes, the vast majority of the prepaid cards are inactive until scanned at a third-party retailer's register. This is called a point

¹ TracFone sells Airtime directly to users ("Direct Sales"). TracFone's direct sales occur through different modes, including over the air directly from a handset ("OTA"), through TracFone's website or over the telephone. TracFone requires a customer to provide a credit card for each direct sale, and the credit card's billing address, and provides an option for the each purchaser to provide additional contact information. For purchases sourced to Montana, TracFone assesses and collects the statutory RTET rate. TracFone has reported and remitted the RTET on its direct sales. These direct sales are not at issue in this matter.

During the audit period, TracFone had a contract with Western Union to sell TracFone Airtime. Under the applicable contract, unlike all other retailer contracts, Western Union sold on TracFone's behalf and reported all its sales to TracFone. TracFone reported and remitted RTET on all sales occurring at Western Union locations within Montana as part of TracFone's direct sales. These sales are also not at issue in the matter.

of sale activation (“POSA”). Until a particular card is activated, it cannot be used to load or redeem airtime. In a normal POSA transaction, a retailer’s customer selects a prepaid card from the retailer’s rack and takes it to the retailer’s check out register. When the card is scanned at the retailer’s register, the retailer’s computer system communicates with the TracFone system through a third party electronic intermediary to activate the card being purchased. This process is nearly instantaneous, and happens automatically upon scanning by the retailer’s clerk.

Once activated, the end-user can input the PIN Code from the prepaid card into a handset to redeem the airtime purchased. The process of loading units on a handset is referred to by TracFone as “Redemption.” The redemption for prepaid cards does not occur at the time of purchase from the third party retailer. Thus the purchaser is not necessarily the end-user of the airtime purchased on a prepaid card. TracFone sets a manufacturer’s suggested retail price (“MSRP”) for each of its products, and in wholesale transactions sells to retailers or distributors at a price based on a contractual discount from that MSRP. TracFone does not require third parties to sell at MSRP, and does not know what retailers actually collect from their own customers.

Thus, TracFone’s redemption revenue does not necessarily reflect the sales price actually charged nor the details of the purchase.

DOR employee, Russ Trasky, conducted an audit on behalf of the Department of TracFones’ RTET returns for the audit period. During his audit visit to TracFone’s offices, Mr. Trasky requested information about Montana sales. TracFone was not able to provide sales information beyond its direct sales but provided a report of redemption revenue for Montana users. On April 22, 2009, Mr. Trasky sent a notice of additional assessment to TracFone for portions of tax year 2004, tax years 2005-2008, and portions of tax year 2009 (the “Assessment”). TracFone timely appealed the assessment.

STANDARD OF REVIEW

The purpose of summary judgment is to dispose of those actions which fail to raise genuine issues of material fact, thereby eliminating the burden and expense of an unnecessary trial. *Berens v. Wilson*, 46 Mont. 269, 806 P.2d 14 (1990). The Board has authority to grant summary judgment in appropriate cases under the Montana Administrative Procedures Act. *Matter of Peila*, 249 Mont. 277, 280, 815 P.2d 139, 144 (1990).

Summary judgment is appropriate if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *Miller v. Herbert*, 272 Mont. 132, 137, 900 P.2d 273, 276 (1995). Once the movant demonstrates that no genuine issue of material fact exists, the burden shifts to the non-moving party to prove, by more than mere denial and speculation that a genuine issue of material fact exists. *Bruner v. Yellowstone County*, 272 Mont. 261, 264, 900 P.2d 901, 903 (1995).

RULES OF STATUTORY CONSTRUCTION

The starting point for statutory construction in Montana is the “plain meaning rule.” See *Western Energy Co., v. Dept. of Revenue*, 297 Mont. 55, 58, 990 P.2d 767, 769 (1999); *Dept. of Revenue v. Dray*, 266 Mont. 89, 92, 879 P.2d. 651, 652 (1994); *Lodge Grass High School District No. 2 v. Hamilton*, 264 Mont. 290, 293, 871 P.2d. 890, 892 (1994) “If the plain meaning of the statute is clear from the language, we apply the law as written by the legislature and look no further to determine the legislature’s intent.” *Lodge Grass*, 264 Mont. at 293. In construing a tax statute, like any other statute, it is the established rule that “the office of the judge is simply to ascertain and declare what is in terms or in substance contained therein, not to insert what has been omitted or to omit what has been inserted.” Section 1-2-101, MCA; *Montana Dept. of Revenue v. American Smelting and Refining Co.*, 173 Mont. 316, 324, 567 P. 2d 901, 905 (1977). Montana law provides that when a taxing statute is susceptible of two meanings, it is ambiguous and should be strictly construed against the taxing authority

and in a light most favorable to the taxpayer. *See Western Energy Co.*, 297 Mont. at 58, 990 P.2d at 769 and *Canbra Foods Ltd. v. Dept. of Revenue*, 278 Mont. 368, 373, 925 P.2d. 855, 857-858 (1996).

BOARD FINDINGS OF FACT AND CONCLUSIONS OF LAW

Statutory Framework

The Department's assessment determined that TracFone is liable for taxes on sales relating to its prepaid cards sold by third party retailers. In reviewing the statutory language, we disagree.

“Every claim for exemption from taxation should be denied unless the exemption is granted so clearly as to leave no room for any fair doubt.” *Cruse v. Fischl*, 55 Mont. 258, 267, 175 P. 878, 881 (1918). In this instance, there is no room for fair doubt that TracFone is exempt from RTET based on the plain reading of the relevant statutes.

In the late 1990's, the Legislature rewrote a variety of taxing statutes, including those relating to telecommunications. In relation to this matter at hand, the Legislature enacted the Retail Telecommunications Excise Tax Act to impose “an excise tax on the purchasers of telecommunications services.” Section 15-53-128, MCA. The RTET is imposed at the rate of 3.75% “on the sales price of retail telecommunications services.” Section 15-53-130, MCA. The tax is imposed on the purchaser, and is required to be collected by the telecommunications service provider. *Id.*

The RTET has a specific set of definitions. The RTET Act defines the term “telecommunications service provider” as “a person providing retail telecommunications services.” Section 15-53-129(14), MCA. Retail telecommunication services, when applied to mobile telecommunications, however, are limited to those services that are “charged to a Montana service address.” Section 15-53-129(10)(b), MCA. Further, the term sales price is defined as “the consideration

paid for the distribution, supply, furnishing, sale, transmission, or delivery of retail telecommunications services to the end-user customer.” § 15-53-129(11)(a), MCA

The term sales price expressly excludes “charges for telecommunications services that have been prepaid by a prepaid calling card that enables the origination of calls by using an access number or authorization code.” Section 15-53-129(11)(b)(xi), MCA.

Further, for purposes of the RTET Act, only those mobile telecommunication services that are “provided in this state to a customer for which the charges are billed by or for the customer's home service provider” are considered subject to tax if the other conditions are met. Section 15-53-131, MCA. This statutory section works with the additional RTET statutory language which requires the taxpayer to be allowed to contest the tax listed on a bill and requires the provider to separately state the amount of tax on the end-user customer’s bill or statement. Sections 15-53-131(4)(a) and 135, MCA.

Statutory Review

The DOR argues that the definition of prepaid calling card cannot be applied to the TracFone card, and thus, TracFone cannot take advantage of the statutory exemption for pre-paid cards. We disagree.

The sales of TracFone’s prepaid cards are not subject to tax under any of the requirements of the statute, and TracFone is not legally required to collect any RTET on its prepaid calling cards. As a result, the Department’s assessment is incorrect.

In reviewing the plain language of the statute, the sales price for RTET purposes does not include “charges for telecommunications services that have been prepaid by a prepaid calling card that enables the origination of calls by using an access number or authorization code.” Section 15-53-129(11)(b)(xi), MCA. The TracFone prepaid cards satisfy these requirements.

The statute exempts all telecommunication services that are prepaid using a qualifying card. The statute requires that the card “enables the origination of calls” through use of a code. Section 15-53-129(11)(b)(xi), MCA. TracFone’s prepaid cards satisfy the statutory language as there can be no dispute they are prepaid calling cards that enable the origination of calls by using an access number or authorization code. In order to use a handset, the user is required to enter the PIN code from the card so the units can be loaded or redeemed on to his or her handset. This PIN code falls within the plain meaning of the term access number or authorization code. The redemption “authorizes” or makes the handset ready to originate calls. Put in statutory terms, the code, once entered, enables a TracFone user to originate calls from his or her handset. All telecommunication services accessed from the handset, once a prepaid card is loaded, fall within the class of “telecommunications services that have been prepaid with a prepaid calling card. . .” Section 15-53-129(11)(b)(xi), MCA.

The Department’s counsel argued that TracFone’s prepaid cards did not fall within the prepaid calling card exception because the TracFone card does much more than merely enable origination of calls, such as provide access to the internet. The plain language of the statute contradicts this strained argument. Nothing in the statute limits its application to merely enabling origination of calls, or using only wireline service, or even requires entry of the number or code for each call. The Department’s argument inserts requirements into the statute that simply do not exist in the plain reading.

The DOR also charges that merely because TracFone does not choose to collect information at the point of sale, e.g., the sales price to the customer, whether the purchaser is the end-user, or even a service address does not exempt it from this tax. The DOR argues TracFone’s claim that it “cannot” charge to a Montana service address because it elects not to collect any customer service address information on

an indirect sale as part of its chosen business model is not a legitimate excuse for failing to remit RTET on the card sales.

Nevertheless, this is exactly the same issue faced by all telecommunications service providers who sell prepaid calling cards and possibly is the reason for the prepaid card exclusion. TracFone does not collect this information because it has no need to do so. Prepaid cards are exempt from the RTET by the clear language of the statute, and we see no distinction between this model and that of any prepaid calling card. It is legislative prerogative to exempt such a business from collection of taxes, and in this case, it has clearly done so in the plain language of the statute.

Wholesale Sales to Retailers

It is important to note that in the case of the RTET, TracFone is not the taxpayer, but rather as a telecommunications services provider, TracFone acts as a collection agent for the Department.

As outlined above, the RTET is imposed on the purchaser. Section 15-53-130, MCA. The Act defines customer or purchaser as the person “who acquires for consideration retail telecommunications services for use or consumption and **not for resale.**” Section 15-53-129, MCA. The terms expressly exclude resellers, which are further defined as “a provider who purchases mobile telecommunications services from another telecommunications services provider and then resells, uses as a component part of, or integrates the purchased services into a mobile telecommunications service.” Section 15-53-129, MCA. Furthermore, the measure of the tax base is the sales price which is the “consideration paid for the distribution, supply, furnishing, sale, transmission, or delivery of retail telecommunications services to the end-user customer.” Section 15-53-129(11)(a), MCA. The RTET must be “separately stated on the end-user customer’s bill or statement.” Section 15-53-135, MCA. Clearly, the statute is not intended to tax the purchase by the retailer as they are not the end-users and do not receive a customer’s bill.

There is no dispute that TracFone collects and remits RTET on its direct sales, in which it is in direct contact with the purchaser and collects the tax. The customer indicates during the purchase transaction he or she has a billing address in Montana. TracFone is able to then properly calculate and reflect the RTET charge on the customer's online receipt, and does so. TracFone reports the actual sales price and remits the RTET with its return.²

The Department acknowledges that TracFone does not have contact or privity with the person purchasing prepaid cards from third parties at the time of purchase and consequently, TracFone cannot collect the RTET due from that customer. Thus, TracFone's wholesale transactions are not sales subject to the RTET.

This comports with the statutory requirement that the excise tax imposed by this part must be separately stated on the end-user customer's bill or statement and further, a customer is allowed a credit against such tax if the tax has been paid in another state. *See* Section 15-53-135. Under this tax scheme, in some method, the taxpayer must be notified of the excise tax and the ability to challenge or get credit for such a tax.

DOR Policy Arguments

The DOR presents a multitude of arguments for its attempt to collect RTET on TracFone's prepaid calling cards. DOR contends that TracFone should not be able to avoid collection tax because of its business practices of not collecting an address or otherwise should be required to change its business model to properly collect and report RTET taxes on the sale of prepaid cards.

The Department suggests that TracFone should pay RTET based on user's redemptions. During depositions, however, the Department's witnesses acknowledged that redemptions are not a taxable event. As a result, the

² TracFone treats sales through Western Union as Direct Sales because Western Union is contractually acting as TracFone's agent. TracFone reports and remits tax on sales that occur at Western Union locations in Montana.

Department's witnesses acknowledges there is no taxable transaction in a wholesale transaction, but asserts TracFone should remit tax nonetheless.

The Department also suggests sales that physically occur in Montana may not be taxable if the prepaid card is redeemed to a handset assigned an activation ZIP code for a different state, while sales physically occurring in a different state are taxable in Montana if the prepaid card is ultimately redeemed to a handset with a Montana activation ZIP code. The Department suggests, via McKeon's deposition, TracFone needs to develop a system that would require third party retailers at any location in the United States to solicit information from a purchaser about what zip code the prepaid card he or she is purchasing is going to be redeemed and collect tax from anyone who indicates a Montana zip code. Under this model, Montana retailers similarly would have to solicit and verify the ultimate intended place of use, because the customer's physical purchase in Montana does not satisfy the requirements of the RTET Act. There is simply no basis for the Department to impose this type of responsibility on TracFone or other retailers because prepaid cards are statutorily excluded from the tax. The question of whether TracFone could collect information on the retail purchasers of those prepaid cards is, therefore, not relevant.

Legislative Policy

It is, of course, the purview of the Legislature to determine whether it wishes to impose collection responsibilities on all or certain types of prepaid cards or otherwise amend the statutory exemptions if it so desires to require the collection of tax on prepaid calling cards.

This Board would note the majority of prepaid calling cards, such as those sold for long distance telephone calls, are generally used on telephones or telecommunication devices in which a RTET is already being paid. For example, RTET is already being paid on a landline or wireless phone when using a long-distance prepaid phone card because the owner of the landline phone is being taxed

through their regular phone bill. In TracFone’s case, there is certainly a policy argument that no RTET is captured because the handset is not separately capturing RTET when the retailer, who is not the provider of the telecommunication services as required by statute, sells the prepaid card. While this may be a policy issue, there is no justification for the DOR’s strained interpretation of clear legislative language. Should the legislature determine it wishes to capture RTET taxes on prepaid calling cards, which provide additional benefits beyond enabling the initiation of calls or which use handsets not subject to RTET, the legislature need only change its exemption language.

Additionally, as a policy matter, it is troubling for the Board that the DOR argues that TracFone, a telecommunications service provider, is required to collect and remit taxes on its prepaid calling card, when the DOR specifically admits that AT&T and other telecommunications service providers are not required to collect and remit taxes on their prepaid calling cards, and it has no anticipation of requiring them to do so. We can find no statutory or factual distinction between the TracFone prepaid calling card “that enables the origination of calls” through the use of a PIN code and the fact that the TracFone prepaid calling card can, in addition, allow for receipt of calls or some additional features that the other pre-paid calling cards available in the marketplace do not provide.

CONCLUSION

For the foregoing reasons, the Board finds and concludes there are no genuine issues of material fact, and TracFone is entitled to judgment in its favor.

ORDER

IT IS THEREFORE ORDERED that TracFone’s motion for summary judgment is granted and the Department of Revenue’s assessment concerning the relevant tax years is reversed.

DATED this 20th day of July, 2011.

BY ORDER OF THE
STATE TAX APPEAL BOARD

/s/ _____
KAREN E. POWELL, Chairwoman

(S E A L) /s/ _____
DOUGLAS A. KAERCHER, Member

/s/ _____
SAMANTHA SANCHEZ, Member

Notice: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 20th day of July, 2011, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mail, postage prepaid, addressed to the parties as follows:

Michael W. Green	<input checked="" type="checkbox"/>	U.S. Mail, Postage Prepaid
CROWLEY FLECK PLLP	<input type="checkbox"/>	Hand Delivery
100 North Park Avenue, Suite 300	<input type="checkbox"/>	E-Mail
P.O. Box 797	<input type="checkbox"/>	Interoffice
Helena, Montana 59624-0797		

Joel Silverman	<input type="checkbox"/>	U.S. Mail, Postage Prepaid
Tax Counsel	<input type="checkbox"/>	Hand Delivery
Office of Legal Affairs	<input type="checkbox"/>	E-Mail
Department of Revenue	<input checked="" type="checkbox"/>	Interoffice
PO Box 7701		
Helena, Montana 59604-7701		

/s/ _____
DONNA EUBANK
Paralegal