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IRS Provides Relief for Gift Card Issuers

Tax Alert

01.10.2011

On January 5, 2011, the IRS and Treasury issued two revenue procedures (Rev. Proc. 2011-17 and Rev. Proc. 2011-18) addressing the treatment of payments received for gift cards. The first provides a safe-harbor method of accounting for gift cards issued in exchange for returned merchandise, while the second involves income deferral for gift cards that can be redeemed by a third party (including the so-called "giftco" issue).

Under Rev. Proc. 2011-17, a retailer may treat the issuance of a gift card in exchange for returned merchandise as if it paid the customer a cash refund which the customer then used to purchase the gift card. Under this treatment, the retailer can recognize the liability for the refund immediately while deferring the income arising from the advance payment for the gift card. This effectively allows the same tax treatment regardless whether the customer's refund is paid in cash or with a gift card.

Rev. Proc. 2011-18 resolves several issues arising from the IRS's position that in order to defer an advance payment for a gift card, the same entity must both issue and redeem the gift card (*i.e.*, the same entity receiving the payment would itself provide goods or services in redemption of the gift card). Under many gift card programs, however, the gift card seller is not necessarily the same entity that will redeem the gift card. Rev. Proc. 2011-18 provides that, so long as the other requirements for deferral under Rev. Proc. 2004-34 are satisfied, a taxpayer that sells gift cards redeemable through other entities will be treated the same as a taxpayer that sells gift cards redeemable only by that taxpayer.

Rev. Proc. 2011-18 potentially will benefit taxpayers selling gift cards through a number of arrangements. Examples of those potentially benefitting from Rev. Proc. 2011-18 include:

- Members of an affiliated group using a gift card subsidiary ("giftco") to sell gift cards that may be redeemed for goods and services provided by the gift card subsidiary or by other members of the group;
- A franchisor or franchisee that sells gift cards that may be redeemed for goods or services provided by other independently-owned franchisees;
- A restaurant management company that sells gift cards that may be redeemed by participating restaurants in different geographic locations or with different trade names; or
- A retailer that issues a gift card that may be redeemed for merchandise at the retailer's stores, retail stores operated by a related party, or retail stores operated by unrelated parties.

Taxpayers taking advantage of Rev. Proc. 2011-18 are limited to the one-year deferral available under Rev. Proc. 2004-34 (available for prepayments for the sale of either goods or services). The more generous two-year deferral under Treas. Reg. § 1.451-5 (available for prepayments for the sale of goods) is not available unless the issuer of the gift card also "holds" the goods for sale.

Under both revenue procedures, taxpayers not already using the permitted methods generally can change their accounting methods under the automatic consent procedures of Rev. Proc. 2008-52. For taxpayers already using the permitted methods, the IRS will not raise the issue on audit, and if the IRS already has raised the issue, the issue will not be pursued further.

While both revenue procedures are generally favorable and should enable taxpayers to resolve much of the controversy surrounding both of the issues, taxpayers must properly implement the new methods of accounting and otherwise properly defer advance payments in order to benefit from the revenue procedures.

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Furthermore, the revenue procedures address only four of the 19 issues identified in the Industry Director's Directive on the Planning and Examination of Gift Card/Certificate Issues in the Retail and Food & Beverage Industries. Thus, to ensure that they benefit from the revenue procedures and minimize their audit risk on gift card issues, taxpayers should evaluate their policies, procedures, and methods of accounting for gift card sales, and implement changes wherever necessary.

If you have any questions regarding the forgoing, would like assistance in evaluating the policies, procedures, and methods of accounting for gift card sales, please contact Steve, Patricia, or either of us at the numbers or e-mail addresses shown below. We would be pleased to discuss this with you or others in the company, as appropriate.

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