

Retail Tax Flash

New Federal tax developments
from Grant Thornton's National Tax Office

Nov. 6, 2009

IRS limits the deferral of gift card revenue

The IRS has issued a string of guidance over the last 18 months that affects when and if retailers can defer revenue from gift card sales for tax purposes.

Gift cards have grown into a vital source of income for many stores and retail locations, especially as recognition of this revenue can be deferred in some instances. Generally, an accrual method taxpayer must recognize revenue when cash is received, but gift card sales often fall under two exceptions provided by IRS guidance.

Treasury Reg. § 1.451-5 allows taxpayers to defer certain revenue from advanced payments for two-years when the payments are for the future sale of goods held by the taxpayer. Rev. Proc. 2004-34 provides a broader one-year deferral of advanced payments for either goods or services.

Unfortunately, the IRS is challenging and denying this deferral in many instances. Examiners are actually required to raise many gift card issues during examination under two IRS directives (LMSB-04-0507-039 and LMSB-04-0808-042). Some of these issues also require examiners to coordinate with industry experts within the IRS.

Using a "gift card company"

Many retailers create subsidiaries to manage their gift card programs. If these gift card companies are separate wholly-owned subsidiaries that do not provide goods or services of their own, the IRS has made clear in recent guidance (FAA 20093801F, FAA 20082801F, and TAM 200849015) that it will not allow either the two-year deferral under Treas. Reg. § 1.451-5 or one-year deferral under Rev. Proc. 2004-34.

The IRS theory in these cases is that cash received by the gift card companies does not represent an "advance payment" as defined for purposes of the revenue procedure or regulations. The IRS also rejects the argument that the cash received by the gift card company is merely a deposit.

Cross redemption situations

The IRS has also moved to block the deferral of gift card revenue when a gift card can be redeemed at different businesses that are separate entities. This will affect retailers that offer gift cards that can be redeemed at either corporate-owned outlets or franchises. It will

Contact information

Mark Wuller
National Practice Leader,
Retail
T 314.735.2199
E Mark.Wuller@gt.com

David Auclair
National Tax Office
T 202.521.1515
E David.Auclair@gt.com

Rich Shevak
National Tax Office
T 202.521.1569
E Rich.Shevak@gt.com

www.GrantThornton.com/tax



also affect gift cards that can be used at different stores that may be part of the same consolidated group.

Next steps?

Grant Thornton is familiar with the issues raised by the IRS guidance and understands the challenges. An accounting methods expert can provide a quick analysis of your situation and identify areas of risk or planning opportunities. If necessary, change can be made in order to prevent potential issues in the future.

Tax professional standards statement

This document supports Grant Thornton LLP's marketing of professional services and is not written tax advice directed at the particular facts and circumstances of any person. If you are interested in the subject of this document we encourage you to contact us or an independent tax advisor to discuss the potential application to your particular situation. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this document may be considered to contain written tax advice, any written advice contained in, forwarded with, or attached to this document is not intended by Grant Thornton to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.