New Accounting Rules for Gift Cards Redeemable by Unrelated Entities

Article By:

Anne Marie Estevez

Gregory T. Parks

William F. Colgin, Jr.

Richard S. Zarin

Barton W.S. Bassett

IRS modifies rules allowing the deferral method of accounting for advance payments received for the sale of gift cards that are redeemable by an unrelated party.

On July 24, the Internal Revenue Service (IRS) released an advance copy of Revenue Procedure 2013-29, which clarifies when a taxpayer may defer recognizing, in gross income, certain advance payments received from the sale of gift cards that are redeemable for goods or services by an unrelated party. This revenue procedure modifies and clarifies Revenue Procedure 2011-18, which modified and clarified Revenue Procedure 2004-34.

Revenue Procedure 2013-29 states that, where a gift card is redeemable by an entity whose financial results are not included in the taxpayer's applicable financial statement (AFS), the taxpayer will recognize the payment in income to the extent the gift card is redeemed. For a taxpayer without an AFS, the taxpayer will recognize the payment in income when it is earned, which, in this situation, is when the gift card is redeemed. Any payment received by the taxpayer that is not recognized in income in the year of receipt must be recognized in the subsequent year.

Retail companies should consult their legal advisers with respect to the application of this revenue procedure to their sale of gifts cards or gift certificates.

Background

Under the deferral method of accounting provided in Revenue Procedure 2004-34, an accrual method taxpayer that receives an advance payment for goods or services must include the advance payment in gross income in the taxable year of receipt to the extent recognized in revenues in the taxpayer's AFS for that taxable year. For a taxpayer without an AFS, an advance payment must be included in gross income to the extent earned in the taxable year of receipt. Any portion not included in gross income in the year of receipt must be included in gross income in the next succeeding taxable year.

Revenue Procedure 2011-18 expanded the definition of "advance payment" provided in Revenue Procedure 2004-34 to include an "eligible gift card sale" and allowed a taxpayer that sells an eligible gift card redeemable through another entity (that may or may not be related to the taxpayer) to use the deferral method of accounting.

To qualify as an advance payment, the payment must be recognized by the taxpayer (in whole or in part) in revenues in its AFS for a subsequent taxable year, or, for taxpayers without an AFS, the payment must be earned by the taxpayer (in whole or in part) in a subsequent taxable year.

However, if a gift card is redeemed by an unrelated entity whose financial statement revenues are not consolidated with the taxpayer's revenues on the taxpayer's AFS, the taxpayer will never recognize any portion of the gift card sale proceeds in revenues in its AFS because that revenue is accounted for only by the unrelated redeeming entity upon the sale of goods or services. Similarly, for a taxpayer without an AFS, the payment is never earned by the taxpayer because the payment is earned by the unrelated redeeming entity.

Revenue Procedure 2013-29's Modification of "Eligible Gift Card Sale"

The U.S. Department of the Treasury and the IRS have concluded that a taxpayer should not be precluded from using the deferral method of accounting provided in Revenue Procedure 2004-34 solely because the taxpayer never recognizes payments from an eligible gift card sale in revenues in its AFS, or, for taxpayers without an AFS, never earns payments from an eligible gift card sale.

Accordingly, Revenue Procedure 2013-29 modifies the term "eligible gift card sale" to provide that an eligible gift card sale is the sale of a gift card (or gift certificate) if (1) the taxpayer is primarily liable to the customer (or holder of the gift card) for the value of the card until redemption or expiration and (2) the gift card is redeemable by the taxpayer or by any other entity that is legally obligated to the taxpayer to accept the gift card from a customer as payment for qualifying items. If a gift card is redeemable by such other entity whose financial results are not included in the taxpayer's AFS, a payment will be treated as recognized by the taxpayer in revenues in its AFS to the extent the gift card is redeemed by the entity during the taxable year. For a taxpayer without an AFS, if a gift card is redeemable by such other entity, including an entity whose financial results are not included in the taxpayer's financial statement, a payment will be treated as earned by the taxpayer to the extent the gift card is redeemed by the entity during the taxable year.

Effective Date

The modification provided by this revenue procedure will be treated as in effect as of the effective date of Revenue Procedure 2011-18, i.e., taxable years ending on or after December 31, 2010.

Audit Protection

For taxable years ending before December 31, 2010, the modification provided by this revenue procedure is to be treated as originally included in Revenue Procedure 2011-18 and thus eligible for audit protection to the extent provided in Revenue Procedure 2011-18.

National Law Review, Volume III, Number 211