

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Internal Revenue Service
Attn: Manager

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subject: Fuel reward; Section 1.451-4

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
X =
Y =
A =
B =
C =
D =
E =
F =
G =
H =
L =
M =
Q =
Date 1 =
Date 2 =

ISSUE

Whether Taxpayer can reduce from gross receipts the estimated future cost of fuel reward card redemptions under Treas. Reg. Sec. 1.451-4 in the year that the rewards are earned, i.e., the year that the Y products with linked fuel money are purchased?

CONCLUSION

Yes. Gross receipts may be reduced in the year that the rewards are earned.

FACTS

Taxpayer is a _____ located in X. The company consists of A grocery stores operating under the name Y. The company offers a fuel reward program to its customers. Under the fuel reward program, the customer signs up for a free Y fuel reward card at an Y grocery store. Each week, Y will have up to B products throughout the store with fuel money linked to them. Fuel rewards will range anywhere from C to D in fuel. The reward amount will depend on the actual item purchased. The money earned (fuel reward) is electronically loaded to an enrolled customer's fuel card and can be redeemed for gas at any participating Q, an unrelated company. Unlike at some grocery stores, the customers do not earn money off a gallon of gas. Rather, Y customers are entitled to free fuel up to the amount of money loaded on the card. Basically, a customer inserts the fuel card just like any credit card, and the pump goes off when the total amount of money loaded on the card is reached, or sooner if the customer stops pumping gas. If the customer desires to purchase more gas than the amount loaded on the fuel reward card, the process of purchasing gas starts over, i.e., either cash or a credit card. Q will honor the fuel card without condition.

Q will prepare and provide to Y a weekly report that includes the following information: the fuel reward redemptions at each participating Q; the aggregate amount of rewards redeemed by enrolled customers during the reporting period; the total number of fuel card gallons to which rewards applied; and the fuel purchase rebate. Within G business days of receiving the report, Y will remit payment to Q in the amount billed for redeemed rewards less the fuel purchase rebate.¹ Q rebates to Y an amount equal to L cents per fuel card gallon. Customers keep the same fuel card indefinitely and rewards are continually added to that card as they are earned. If the card is inactive for H, then the card is deactivated. If the program is terminated, by Q or Y, the fuel rewards will continue being honored for M months.

Y's treatment for both book and tax is to immediately expense the fuel rewards at the time of issuance. On Date 1 and Date 2, the ending tax years at issue, Taxpayer's fuel rewards liability had a balance of E and F, respectively.

¹ Q and Y use an average retail price of a gallon of gas at each respective store.

LAW AND ANALYSIS

The Code allows a deduction for "expenses paid or incurred during the taxable year in carrying on any trade or business." I.R.C. § 162(a). Under the accrual method of accounting, a liability is incurred, and generally is taken into account in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Section 461(h)(4); Treas. Reg. § 1.461-1(a)(2)(i). See also United States v. Hughes Properties, Inc., 476 U.S. 593, 600 (1986).

Section 1.451-4 is an exception to the "all-events" test under § 461(h)(4). Section 1.451-4(a)(1) provides as follows:

If an accrual method taxpayer issues trading stamps or premium coupons with sales . . . and such stamps or coupons are redeemable by such taxpayer in merchandise, cash, or other property, the taxpayer should, in computing the income from such sales, subtract from gross receipts with respect to sales of such stamps or coupons (or from gross receipts with respect to sales with which trading stamps or coupons are issued) an amount equal to . . . (i) The cost to the taxpayer of merchandise, cash and other property used for redemptions in the taxable year, (ii) Plus the net addition to the provision for future redemptions during the taxable year (or less the net subtraction from the provision for future redemptions during the taxable year).

In Rev. Rul. 78-212, 1978-1 C.B. 139, the Service ruled that § 1.451-4 did not apply to discount coupon expenses because the right of redemption must be unconditional. That is, the coupons must be redeemable without additional consideration from the consumer. The Service indicated that the intent of § 1.451-4 is to match, in the same taxable year, revenues with the expenses incurred in producing those revenues.

Citing to Rev. Rul. 78-212, the Tax Court has determined that discount coupons are not premium coupons, and accordingly, are not subject to § 1.451. Giant Eagle, Inc. v. Commissioner, T.C. Memo. 2014-146, rev'd on other grounds, 822 F.3d 666 (3d Cir. 2016). In Giant Eagle, via a fuel reward program, the taxpayer issued coupons that could be used for a discount on the purchase of a gallon of gas. The Service argued that § 1.451-4 did not apply because the coupons were not redeemable in merchandise, cash, or other property. Rather, the coupons were conditioned on the customer purchasing additional gas. The Tax Court agreed.

Allowing a present deduction with respect to redemptions conditioned on an additional purchase can result in a mismatching of expenses and revenues, contrary to the regulation's primary purpose. Fuelperks! are

stated in terms of a discount on the purchase price of merchandise. Indeed, each fuelperk! is redeemable for a 10-cent reduction to the purchase price per gallon of gas. As previously mentioned, we recognize that fuelperks! discounts can be combined to potentially offset the entire purchase price of a gallon of gas; however, this does not cause them to lose their nature as discounts. Accordingly, as was the case with the coupons issued with sales in the ruling, the redemption of fuelperks! is conditioned on a subsequent purchase, making them not redeemable for merchandise, cash, or other property. We therefore hold that petitioner is not entitled to offset the estimated future costs of redeeming fuelperks! against sales revenues under section 1.451-4(a)(1).

Id. at 6. In the subject case, the customers earned fuel rewards that were redeemable for gas. The money earned is electronically loaded to an enrolled customer's fuel card and can be redeemed for gas at any participating Q. The customer inserts the fuel card just like any credit card, and the pump goes off when the total amount of money loaded on the card is reached, or sooner if the customer stops pumping gas. We do not find this to be a discount. Rather, we believe that the rewards are redeemable for other property; specifically, gas purchased by Y from Q.

Under § 1.451-4, the coupon must be "redeemable by such taxpayer." An argument can be made that Q, rather than Taxpayer, redeems the coupons; accordingly, § 1.451-4 does not apply.² We do not support such an interpretation. Neither the statute nor the regulations define "redeemable by such taxpayer." We believe that Taxpayer effectively is redeeming the coupons for other property by paying for the gas that customers "pick up" at Q. It's no different than a taxpayer offering "other property" to customers that taxpayer purchases from a third-party and that its customers pick up directly from the third-party. Here, Taxpayer is paying for the gas, minus the rebate. The fuel agreement is between Taxpayer and Q, whereby Q agrees to redeem the gas, and Taxpayer agrees to pay for it. Further, we do find some indirect support that Taxpayer is considered as redeeming the coupon. In Rev. Rul. 74-69, 1974-1 C.B. 113, the Service found that coupons issued by a gambling casino to gaming winners did not qualify under § 1.451-4 because the coupons were issued in relation to winning, not sales. The prize coupons could have been redeemed for cash, or merchandise from third-parties who were then reimbursed by the gambling casino. The ruling's reasoning did not include any analysis that the coupons were not redeemable by the taxpayer, notwithstanding that the coupons could be redeemed for third-party merchandise. Further, the underlying G.C.M. 35524 (October 19, 1973) likewise did not reference such an argument. The failure by the ruling and GCM to make this argument indirectly supports the position that this was not a concern.

Moreover, in line with both Rev. Rul. 78-212 and the Tax Court in Giant Eagle, applying § 1.451-4 in this case would be consistent with the section's purpose to match sales

² When the construction of a term granting relief from the general rule of nondeductibility requires interpretation, as with provisions concerning exemption from taxation, it is preferable to construe that term narrowly. Rev. Rul. 78-97, 1978-1 C.B. 39.

revenues with expenses incurred to generate those revenues. Here, clearly, Taxpayer initiated the reward program to increase sales of its products; not to increase gas sales at Q, a third-party. Notable, this case is distinguishable from Giant Eagle where the Tax Court disallowed the current deduction with respect to discounts conditioned on an additional purchase of gas from the taxpayer.

We note that Taxpayer has not yet complied with § 1.451-4 in computing its subtraction from gross receipts. Our understanding is that Taxpayer is working on these computations, which will be reviewed by Exam.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call _____ if you have any further questions.

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