

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 451; 461; 1.451-5)

Rev. Proc. 2011-17

PURPOSE

This revenue procedure provides a safe harbor method of accounting for the treatment of gift cards issued to customers in exchange for returned merchandise. This revenue procedure also provides administrative procedures for a taxpayer within the scope of this revenue procedure to obtain consent to change to the method of accounting permitted in section 4 of this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 451 of the Internal Revenue Code provides that the amount of any item of gross income is recognized in the taxable year the taxpayer receives the item unless, under the method of accounting used in computing taxable income, the income is properly recognized in a different period. Section 1.451-1(a) of the Income Tax Regulations provides that, under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. All the events that fix the right to receive income generally occur when (1) the taxpayer earns the

payment through performance, (2) payment is due to the taxpayer, or (3) the taxpayer receives the payment, whichever happens first. See Rev. Rul. 84-31, 1984-1 C.B. 127.

.02 A taxpayer generally must recognize advance payments in income in the year of receipt, because receipt satisfies the all events test of § 1.451-1(a). However deferral beyond the year of receipt is permitted in two situations.

(1) Section 1.451-5 generally allows an accrual method taxpayer to defer recognizing advance payments for goods as income until the taxable year the taxpayer recognizes the advance payments in revenue under the taxpayer's method of accounting for financial reporting purposes. However, § 1.451-5(c) limits deferral of substantial advance payments for inventorable goods to the end of the second taxable year following the year the taxpayer receives the payments.

(2) Rev. Proc. 2004-34, 2004-1 C.B. 991, generally allows an accrual method taxpayer to defer recognizing advance payments received for goods, services, or a mixture of goods and services as income until the taxable year the taxpayer recognizes the advance payments in revenue under the taxpayer's method of accounting for financial reporting purposes. However, section 5.02(1)(a)(ii) of Rev. Proc. 2004-34 limits the deferral to the end of the next succeeding taxable year following the year the taxpayer receives the payments.

.03 Section 461(a) provides that a taxpayer takes a deduction or credit in the taxable year that is the proper taxable year under the method of accounting used in computing taxable income. Section 1.461-1(a)(2)(i) provides that, under an accrual method of accounting, a liability (as defined in § 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for federal income tax purposes, 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.

Section 1.461-4(g)(3) provides that economic performance occurs for a refund liability when the refund is paid (whether paid in property, money, or a reduction in the price of goods or services to be provided in the future). Section 1.461-4(g)(3) generally applies to refund liabilities regardless of whether they are characterized as deductions from gross income, adjustments to gross receipts or total sales, or adjustments or additions to cost of goods sold. Thus, for federal income tax purposes, refunds reducing gross receipts generally are incurred when paid. Sections 1.61-3(a) and 1.446-1(c)(1)(ii)(B).

.04 Taxpayers (merchants) commonly handle returns of inventoriable goods in one of two ways. The merchant may give the customer a cash refund in exchange for the returned goods, or the merchant may issue a credit, for example in the form of a gift card, to the customer for the returned goods.

(1) A taxpayer that pays a customer an immediate cash refund for returned goods has incurred a refund liability. The payment satisfies the requirements of § 1.461-1(a)(2)(i) (including economic performance), therefore the taxpayer may reduce gross receipts for the amount of the refund. If the customer uses the refund to purchase a gift card, the taxpayer has received an advance payment from the sale of a gift card. The taxpayer may defer the proceeds of this sale under a method of accounting that complies with either § 1.451-5 or Rev. Proc. 2004-34.

(2) A taxpayer that, instead of paying a cash refund, only will issue a gift card to a customer in exchange for returned goods does not have a fixed liability under § 1.461-1(a)(2)(i) because it is conditioned on the future redemption of the gift card.

.05 Many commentators in the retail industry contend that cash refunds and gift cards provided as refunds for returned goods should be treated the same. The commentators argue that issuing a gift card for returned goods is tantamount to making a cash refund that the customer immediately uses to purchase a gift card. To avoid disputes about the proper characterization of gift cards issued for returned goods, provide better matching of income and costs, and simplify recordkeeping, the Internal Revenue Service will permit a taxpayer within the scope of this revenue procedure to treat gift cards issued for returned goods as the payment of a cash refund and sale of a gift card. A taxpayer may use this method whether or not it is the taxpayer's policy to provide a cash refund for returned goods.

.06 In general, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Sections 446(e) and 1.446-1(e)(2)(i). Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures stating the limitations, terms, and conditions of the Commissioner's consent to change a method of accounting. Section 481(a) generally requires adjustments to prevent duplication or omission of amounts when a taxpayer changes a method of accounting.

SECTION 3. SCOPE

This revenue procedure applies to taxpayers engaged in the trade or business of selling goods at retail that use an overall accrual method of accounting and issue gift cards described in section 4.02 of this revenue procedure in exchange for returned goods.

SECTION 4. APPLICATION

.01 In general. A taxpayer within the scope of this revenue procedure may treat the issuance of a gift card in exchange for returned goods as (1) the payment of a cash refund in the amount of the gift card, and (2) the sale of a gift card in the amount of the gift card. The taxpayer may account for the amount deemed received for the sale of the gift card under § 1.451-5 or Rev. Proc. 2004-34, if otherwise eligible.

.02 Gift cards. For purposes of this revenue procedure, a gift card is any evidence of a promise to provide a specific dollar amount of goods and/or services to a customer in a future sale, whether imprinted electronically on a plastic card, issued electronically with a special code, provided as a printed certificate, or recorded on a taxpayer's books. A card or other evidence of a promise to provide a specific dollar amount of goods and/or services is not a gift card for purposes of this revenue procedure if the customer must perform any act or service in addition to presenting the card, such as purchasing additional products, to obtain the goods and/or services.

SECTION 5. CHANGE IN METHOD OF ACCOUNTING

.01 Consent to change. A change in a taxpayer's treatment of gift cards issued as a refund for returned goods is a change in method of accounting within the meaning of §§ 446 and 481 and the regulations thereunder.

(1) Automatic consent. A taxpayer that wants to change its method of accounting to the method of accounting permitted in section 4 of this revenue procedure must obtain the consent of the Commissioner under § 446(e) and § 1.446-1(e)(3) by following the automatic consent procedures in Rev. Proc. 2008-52, 2008-2 C.B. 587, as modified, amplified, and clarified by Rev. Proc. 2009-39, 2009-38 I.R.B. 371, or its successor, except as provided below. For purposes of section 6.02(4) of Rev. Proc. 2008-52, the

taxpayer must include on line 1a of the Form 3115 the designated automatic accounting method change number 156. A taxpayer may change its method of accounting to a proper method under Rev. Proc. 2004-34 and to the method permitted in section 4 of this revenue procedure on one Form 3115 and must include both change numbers on line 1a.

(2) Advance consent. A taxpayer may change its method of accounting to a proper method under § 1.451-5 and to the method permitted in section 4 of this revenue procedure on one Form 3115 but must use the advance consent procedures of Rev. Proc. 97-27, 1997-1 C.B. 680.

.02 Transition rules. If a taxpayer within the scope of this revenue procedure has timely requested consent on or before January 5, 2011, under Rev. Proc. 97-27 to change its method of accounting for gift cards issued in exchange for returned goods and the Form 3115, Application for Change in Accounting Method, is pending with the national office, the taxpayer may convert its Form 3115 to an application for automatic consent under Rev. Proc. 2008-52, if otherwise eligible. The taxpayer must notify the national office of the conversion before the national office issues a letter ruling under Rev. Proc. 97-27. If the taxpayer converts the Form 3115 under this section 5.02 before the national office has ruled on the Form 3115, the national office will return the Form 3115 to the taxpayer and refund the user fee.

.03 Scope limitations waived. The scope limitations in section 4.02 of Rev. Proc. 2008-52 do not apply to this change in method of accounting for a taxpayer's first or second taxable year ending on or after December 31, 2010. However, if a taxpayer is under examination, before an appeals office, or before a federal court for any income

tax issue when the taxpayer files the copy of the Form 3115 with the national office, the taxpayer must provide a copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent, appeals officer, or counsel for the government, as appropriate.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2008-52 is modified to include in the APPENDIX the automatic change in method of accounting permitted by this revenue procedure.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2010.

SECTION 8. AUDIT PROTECTION

If a taxpayer within the scope of this revenue procedure used a method of accounting permitted by section 4 of this revenue procedure in a taxable year ending before December 31, 2010, the Service will not challenge the use of that method of accounting. Moreover, if the use by a taxpayer within the scope of this revenue procedure of a method of accounting permitted by section 4 of this revenue procedure is an issue under consideration in an examination, in appeals, or before the U.S. Tax Court, the Service will not further pursue the issue.

DRAFTING INFORMATION

The principal author of this revenue procedure is Sean M. Dwyer of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Dwyer at (202) 622-5020.