

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Revenue Agent David Anderson, Team Number 1302
Large & Mid-Size Business (LMSB), Natural Resources & Construction

from: Rogelio A. Villageliu, Senior Counsel &
Industry Counsel (Food & Beverages) (RFP&H) (Large & Mid-Size Business)

subject: Use of Gift Card Disregarded Entity

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

LEGEND

Company A =

Parent =

Entity B =

Year 1 =

Company C =

ISSUE

Whether payments received by Entity B, a single-member limited liability company (LLC) that is wholly owned by Company A, are received for the sale of "goods held by the taxpayer" for purposes of the definition of an advance payment in Treas. Reg. §1.451-5(a) (1)(i), if the gift cards may be redeemed only for goods held for sale by Company A.

CONCLUSION

Yes. Because Entity B is a disregarded entity for federal income tax purposes, Entity B is treated as an unincorporated division of Company A, and therefore as the same taxpayer as Company A, for purposes of the definition of an advance payment in Treas. Reg. §1.451-5(a)(1)(i).

FACTS

Company A is Parent's primary or only operating merchandise retailer subsidiary. Company A owns the retail merchandise inventory that it sells. Company A is the sole member of Entity B, a single-member LLC that is disregarded for federal income tax purposes. Entity B was formed in Year 1 to sell gift cards and otherwise administer Company A's gift card program.¹ Company A's inventory is used to redeem the gift cards sold by Entity B. Entity B has no title to merchandise inventory, nor its own facilities or stores, and it performs no other activities except for the administration of the gift card program. Parent, Company A and Entity B use the accrual method of accounting for tax purposes.

Assuming the gift card payments received by Entity B are received for the sale of goods "held by the taxpayer," Entity B otherwise is properly using the deferral method of Treas. Reg. §1.451-5(b)(1)(ii) for the income from the sale of gift cards. The taxpayer has attached the required information schedule to its federal income tax returns. See Treas. Reg. §1.451-5(d).

LAW AND ANALYSIS

For taxpayers using the accrual method of accounting, Treas. Reg. §1.451-1(a) provides that income generally 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. Generally, all events that fix the right to receive income occur upon the earliest of when (1) required performance takes place, (2) payment is due, or (3) payment is made. See Schlude v. Commissioner, 372 U.S. 128 (1963). Thus, when a taxpayer receives a payment for goods or services that is includible in the taxpayer's gross income, the taxpayer generally is required to include the payment in income upon receipt, even where the goods or services are to be provided in a future taxable year. See Treas. Reg. §1.451-1(a); Schlude v. Commissioner, *supra*; American Automobile Assn. v. United States, 367 U.S. 687 (1961); Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957); and Hagen Advertising Displays, Inc. v. Commissioner, 407 F.2d 1105 (6th Cir. 1969).

The taxpayer in this case avails itself of the deferral method found in Treas. Reg. §1.451-5, an exception to the general rule of Treas. Reg. §1.451-1(a), with respect to

¹Entity B has contracted with a third party, Company C, to render services in the administration of Entity B's gift cards. Company C provides Entity B with the detailed accounting of gift card liabilities, redemptions, and outstanding balances.

the proceeds from gift cards sold by Entity B. This deferral method applies to “advance payments,” which are defined in pertinent part as amounts “received in a taxable year by a taxpayer using an accrual method of accounting for purchases and sales..., pursuant to, and to be applied against, an agreement ... [f]or the sale or other disposition in a future taxable year of goods held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business”. See Treas. Reg. §1.451-5(a)(1). The term “agreement” includes a gift certificate that can be redeemed for goods.

In this case, Entity B is disregarded as an entity separate from its owner, Company A, for federal income tax purposes under the rules described in Treas. Reg. §301.7701-3. If a business entity with only one owner is disregarded, its activities are treated in the same manner as a branch or division of the owner. See Treas. Reg. §301.7701-2(a). Therefore, in this case the sales of gift cards and their redemption are deemed to be carried out by the same taxpayer for purposes of the definition of an advance payment in § 1.451-5(a)(1)(i).

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.

This opinion has been coordinated between Industry Counsel (Food & Beverages) Rogelio A. Villageliu, Industry Counsel (Retail) Carol B. McClure (Retail) and Associate Industry Counsel (Retail) Benjamin McClendon. This opinion benefited from the assistance of Technical Advisors Maria A. Montani and Philip J. Hofmann, and the coordination provided by Senior Analyst Cindy S. Kim. The opinion was coordinated with, and reviewed by national office’s CC:ITA:B02.

If you have any questions, please call Industry Counsel (Food & Beverages) Rogelio A. Villageliu at (312) 368-8728.

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