

Office of Chief Counsel  
Internal Revenue Service  
**memorandum**

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to: Lynne M. Murphy  
Internal Revenue Agent

from: Area Counsel (Gulf Coast Area Dallas)  
(Tax Exempt/Government Entities District Counsel)

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subject:

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

ISSUES

1. Whether a discount on the price to \_\_\_\_\_ offered to employees as a qualified employee discount, as defined by I.R.C. §132(c), by the \_\_\_\_\_, is a discount on "services," as opposed to a discount on "property."
2. Whether \_\_\_\_\_ qualifies as a qualified employee discount under I.R.C. § 132(a), where such program allows the employee to sign up a total of \_\_\_\_\_ people, including himself/herself, who may not meet the definition of employee under Treas. Reg. § 1.132-1(b)(1).
3. Whether the Service should use \_\_\_\_\_ published rates in determining the "employee discount" under I.R.C. § 132(c)(3), in order to determine whether the employee discount under \_\_\_\_\_ exceeds the twenty percent discount limitation of I.R.C. § 132(c)(1)(B).

CONCLUSIONS

1. Providing \_\_\_\_\_ for rent is a service. \_\_\_\_\_ performs significant services in connection with the provision of the \_\_\_\_\_. The use of a \_\_\_\_\_ is not property, it is a service.

2. Only employees, as defined by I.R.C. §132(h) and Treas. Reg. § 1.132-1(b)(1), can qualify for a nontaxable fringe benefit under I.R.C. § 132(a), and therefore, \_\_\_\_\_, as it applies to nonemployees, is a taxable fringe benefit.

3. Until such time that \_\_\_\_\_ provides evidence to show otherwise, the Service should apply the published rates in determining the "employee discount" as defined by I.R.C. § 132(c)(3).

### FACTS

The facts are based upon the information you provided. If any of the facts herein are not as you understand them, please advise us as soon as possible.

\_\_\_\_\_ in the United States, provides its employees a discount program called the \_\_\_\_\_. Under the \_\_\_\_\_, employees may designate up to \_\_\_\_\_ individuals, including themselves, to receive a \_\_\_\_\_ discount off published rates for \_\_\_\_\_ services from \_\_\_\_\_. In North America, these individuals can be spouses or domestic partners, family members, and friends of the employee. The employee discount may not be combined with any other promotion and is subject to commercial blackout dates.

In order to participate in the \_\_\_\_\_, the employee and each of his or her \_\_\_\_\_ designated individuals must become \_\_\_\_\_ members. \_\_\_\_\_ membership is offered to the general public at no cost. Members of the \_\_\_\_\_ program receive a point for every dollar spent on \_\_\_\_\_. Such points may be applied to receive discounts on future \_\_\_\_\_. It is not known whether \_\_\_\_\_ employees may apply points to \_\_\_\_\_ in conjunction with their employee discount.

After becoming a \_\_\_\_\_ member, employees must log into the \_\_\_\_\_ and register themselves, as well as each of the \_\_\_\_\_ individuals they have designated to participate in the \_\_\_\_\_, using the \_\_\_\_\_ numbers provided by those individuals. Employees and their designated individuals book \_\_\_\_\_ in the same manner as the general public, including through on-line services such as \_\_\_\_\_ or \_\_\_\_\_. The \_\_\_\_\_ must use their \_\_\_\_\_ number in order to obtain the \_\_\_\_\_ discount.

Through the \_\_\_\_\_, all eligible \_\_\_\_\_ receive a discount of \_\_\_\_\_ percent off the published rates on all \_\_\_\_\_. They also may receive discounted rates \_\_\_\_\_, but that discount rate is not known. \_\_\_\_\_ states that employees may even find discounts greater than \_\_\_\_\_ percent on the open market,

through websites like \_\_\_\_\_ or \_\_\_\_\_ also maintains that the discount offered under the \_\_\_\_\_ is, in most cases, less than the discount rate offered to its large \_\_\_\_\_ customers, or those under \_\_\_\_\_ programs. \_\_\_\_\_ has provided the Service with several bar graphs, illustrating various discounts allowed to \_\_\_\_\_ customers, but has not provided any evidence supporting the information displayed by the graphs. It is not known what percentage of \_\_\_\_\_ total sales come from their large \_\_\_\_\_ customers or other \_\_\_\_\_ programs.

## LAW AND ANALYSIS

### Issue 1

You have asked us to provide you with an opinion on whether \_\_\_\_\_ sells property or services in order to determine whether I.R.C. §§ 132(c)(1)(A) or (c)(1)(B) applies in determining whether the \_\_\_\_\_ is a qualified employee discount under I.R.C. § 132(a). In your request for advice, you state that you believe that the \_\_\_\_\_ is a service, rather than the sale of property. We agree. Although we could not find a case on point, we believe \_\_\_\_\_ is a service, because \_\_\_\_\_ renders significant services in connection with payments it receives for providing \_\_\_\_\_. These services include \_\_\_\_\_.

Further, \_\_\_\_\_ renders these services in connection with each new user of the \_\_\_\_\_. Therefore, \_\_\_\_\_ is providing a service, not the selling of property, and I.R.C. § 132(c)(1)(B) applies in determining whether \_\_\_\_\_ is qualified employee discount under I.R.C. § 132(a).

### Issue 2

I.R.C. § 61(a)(1) provides that gross income includes all income, from whatever source derived, including fringe benefits. Treas. Reg. § 1.61-21(a)(4) provides that a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. Id. I.R.C. § 3501(b) provides that employers must collect and pay employment taxes related to noncash fringe benefits.

I.R.C. § 132(a)(2) excludes from gross income the fringe benefit of qualified employee discounts. For purposes of I.R.C. § 132(a), an employee is defined as an individual currently employed by the employer, an individual who retired from the employer, or became disabled while working for the employer, or a widow or widower of any one of these. I.R.C. § 132(h); Treas. Reg. § 1.132-1(b)(1). Spouses and dependent children of the above mentioned groups are also treated as "employees" for purposes of I.R.C. § 132(a)(2). I.R.C. § 132(h)(2). Dependent children are defined as children who are dependent on the employee, or both of whose parents are deceased and who have not attained age 25. I.R.C. § 132(h)(2)(B); Treas. Reg. § 1.132-1(b)(5).

Only individuals meeting the definition of employee under I.R.C. § 132(h) and Treas. Reg. § 1.132-1(b)(1) qualify for a nontaxable fringe benefit of a qualified employee discount. \_\_\_\_\_ allows employees to designate up to \_\_\_\_\_ other individuals as eligible for the \_\_\_\_\_ percent discount. These individuals do not have to meet the definition of "employee" as defined by I.R.C. § 132(h) and Treas. Reg. § 1.132-1(b)(1). Under the \_\_\_\_\_, such individuals can be \_\_\_\_\_. Basically, the employee can designate any person to participate, regardless of the employee's relationship with that person.

The value of any discount given to an individual through the \_\_\_\_\_ who is not an "employee" as defined by I.R.C. §132(h) and Treas. Reg. § 1.132-1(b)(1) is taxable as income to the employee who designated such individual. Treas. Reg. § 1.61-21(a)(4). Accordingly, \_\_\_\_\_ must collect and pay to the Service employment taxes based on the value of discounts given to individuals through the \_\_\_\_\_ who are not "employees" as defined by Treas. Reg. § 1.132-1(b)(1), on behalf of the employee who designated such "nonemployees" for the program. I.R.C. §3501(b).

### Issue 3

As stated above, I.R.C. § 132(a)(2) excludes from income qualified employee discounts. In the case of services, the term "qualified employee discount" means any employee discount to the extent such discount does not exceed 20 percent of the price at which services are being offered by the employer to its customers. I.R.C. § 132(c)(1)(B). "Employee discount" means the amount that the price at which the services are provided by the employer to an employee is less than the price at which the services are offered by the employer to customers. I.R.C. § 132(c)(3). If the qualified employee discount on services exceeds 20 percent of the price offered to customers, the excess discount is includable in the employee's income. Treas. Reg. § 1.132-3(e). The service for which the discount applies must be one provided by the employer to customers in the ordinary course of its business. I.R.C. § 132(c)(4).

In determining the amount of an employee discount, the price at which the property or service is being offered to customers at the time of the employee's purchase is controlling. Treas. Reg. § 1.132-3(b)(i). Treas. Reg. § 1.132-3(b)(ii) states that "the price at which a property or service is being offered to customers cannot reflect any quantity discount unless the employee actually purchases the requisite quantity of the property or service." Treas. Reg. § 1.132-3(b)(2)(iv) provides that, subject to Treas. Reg. § 1.132-3(b)(ii), in cases where the employer offers a discounted price to a discrete customer, or to consumer groups, and the sale at all such discounted prices comprise at least 35 percent of the employer's gross sales for a representative period, then in determining the employee discount, the price at which such service is being offered to customers for purposes of section 132 is a discounted price. The discounted price is determined by taking the current undiscounted price and reducing it by the percentage discount at which the greatest percentage of the employer's discounted

gross sales are made for such representative period. Id. See also Treas. Reg. 1.132-3(b)(v), Examples 1 and 2. A "representative period" is the taxable year of the employer immediately preceding the taxable year in which the service is provided to the employee at a discount. Treas. Reg. § 1.132-3(b)(2)(iv).

In order for \_\_\_\_\_ to qualify as a qualified employee discount under I.R.C. § 132(a), the employee discount for the \_\_\_\_\_ must not exceed 20 percent of the price at which the \_\_\_\_\_ services are offered by \_\_\_\_\_ to its customers. I.R.C. §§ 132(c)(1)(B) and (3). The \_\_\_\_\_ offers \_\_\_\_\_ employees a \_\_\_\_\_ percent discount off published \_\_\_\_\_ rates. The excess discount of 20 percent would normally be included in the employees' income. Treas. Reg. § 1.132-3(e). However, \_\_\_\_\_ has alleged that it offers discounts that are deeper than \_\_\_\_\_ percent to \_\_\_\_\_ customers and members of \_\_\_\_\_ programs, such as the \_\_\_\_\_ program. \_\_\_\_\_ argues that its "employee discount" should be based upon the discount rates it provides to such corporate customers, instead of its published rates. \_\_\_\_\_ has provided the Service with bar graphs illustrating the discounts it gives to various \_\_\_\_\_ customers, as well as groups such as members of \_\_\_\_\_. But \_\_\_\_\_ has not provided evidence substantiating the information on the graphs, nor has \_\_\_\_\_ provided the Service with evidence showing what percentage of its total sales is made from each of its customers allegedly receiving discounted rates.

In order for the Service to determine whether to apply the pricing and discount rule of Treas. Reg. § 1.132-3(b)(2)(iv), it must know whether 35 percent of \_\_\_\_\_ sales are comprised of discount rates given to discrete customers or consumer groups. If 35 percent of \_\_\_\_\_ total sales are comprised of sales to discrete customers or consumer groups, the Service must know each groups' discount, and the percentage of sales each group contributes to \_\_\_\_\_ total sales. Until such time as this information is provided by \_\_\_\_\_ the Service should use \_\_\_\_\_ published rates in determining the employee discount rate under I.R.C. §132(c)(3). According to \_\_\_\_\_, the discount given under the \_\_\_\_\_ is \_\_\_\_\_ percent off published rates. This rate exceeds the 20 percent discount allowed by I.R.C. § 132(c)(1)(B). Under Treas. Reg. § 1.132-3(e), this excess amount should be included in the income of the employees as a taxable fringe benefit. Accordingly, \_\_\_\_\_ must collect and pay to the Service employment taxes based on the value of the excess 20 percent discount given to employees through the \_\_\_\_\_. I.R.C. § 3501(b).

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 (904) 661-3043 if you have any further questions.

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