

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

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to: Internal Revenue Service
Attn: Manager

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subject: All-events test Reductions

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

LEGEND

Taxpayer =
Program =
Number =
Reduction(s) =
Services =
Location A =

Date 1 =
Year 2 =
Date 3 =
Year 1 =

ISSUE

Whether Taxpayer may deduct the estimated value of Reductions, under the all-events test under section 461, where students have earned Number, but have not yet completed attendance for the first 2 weeks of the following academic term (the following tax year)?

CONCLUSION

Taxpayer's liability for Reductions was not fixed at year end, and accordingly, did not satisfy the all-events test.

FACTS

Taxpayer is among the largest providers of Services. Headquartered in Location A Taxpayer offers academic programs through

¹ Taxpayer targets a large and diverse market, as its educational institutions offer students the opportunity to earn undergraduate and graduate degrees,

Taxpayer implemented a Program in the fiscal year ended Date 1, whereby, subject to the following requirements and , students are provided with a Reduction on the successful completion of Number during a term and complete attendance for the first two weeks of the following academic term (the following tax year for the liability at issue). The following information is contained in the :

¹ Were Taxpayer to seek refund relief and file suit in U.S. District Court for Location A, the decision would be appealable to the United States Court of Appeals for the Circuit.

² We note that Taxpayer was requested to supply whatever document(s) students used to confirm attendance. Taxpayer responded that students do not actually confirm attendance. Rather, Taxpayer confirms the student's registration before applying the Reduction. "

" Taxpayer's response to IDR #8.

Taxpayer initiated the Program in Year 2. On its originally filed Form 1120, for the fiscal year ended Date 1, the estimated Reduction liability was not deducted. After the Third Circuit's opinion in Giant Eagle, Inc. v. Commissioner, 822 F.3d 666 (3d Cir. 2016), nonacq., 2016-40 I.R.B. 424, however, Taxpayer filed an amended return deducting the estimated Reduction liability.³ Taxpayer subsequently filed its Form 1120 for the fiscal year ended Date 3, deducting the estimated Reduction liability consistent with the Year 1 amended Form 1120.

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 an accrual method of accounting, in determining whether an amount has been incurred, one must satisfy the all-events test and determine if economic performance has occurred.⁴ Section 461(h); Treas. Reg. § 1.461-1(a)(2)(i). The all-events test is satisfied if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy. Section 461(h)(4). See also United States v. Hughes Properties, Inc., 476 U.S. 593, 600 (1986).

A taxpayer may not deduct a liability that is contingent or an estimate of an anticipated expense, regardless of statistical certainty, "if it is based on events that have not occurred by the close of the taxable year." United States v. General Dynamics Corp., 481 U.S. 239, 243-44 (1987).

³ Taxpayer estimated that a percentage of the Reduction earned would not be used by students in a subsequent term, either because the student temporarily or permanently withdraws from school. The Taxpayer bases this "estimated breakage" on historical student trends and modifies it as trends evolve.

⁴ No advice is requested, and no opinion is expressed, regarding whether the amount could have been determined with reasonable accuracy or whether the economic performance test was met.

The first prong of the all-events test is the fixed liability prong. We believe that Taxpayer's liability was not fixed until after the student earned Number AND complete attendance for the first 2 weeks of the following academic term. Not until the student completed the attendance requirement would the liability be fixed, assuming the other requirements were satisfied, e.g.,

Otherwise, prior to the following academic term, Taxpayer could only make its best guess as to whether any particular student would remain in school and be entitled to a Reduction. Accordingly, the all-events test has not been satisfied in this case. The clearly states that Taxpayer will not disburse the Reduction if the student fails to meet any of the requirements, which includes the attendance requirement.

The Third Circuit's decision in Giant Eagle, 822 F.3d at 666,⁵ held that a fuel perks program satisfied the all-events test when the customer earned the discount by purchasing groceries, rather than when the customer used the discount to purchase fuel in taxpayer's following tax year. The court agreed with taxpayer that a unilateral contract was formed by year end.

Unlike bilateral contracts, which are premised on reciprocal promises, "unilateral contracts ... involve only one promise and are formed when one party makes a promise in exchange for the other party's act or performance. Significantly, a unilateral contract is not formed and is, thus, unenforceable until such time as the offeree completes performance."

Id. at 673 (citations omitted).

The Third Circuit concluded that the taxpayer's liability was fixed at year's end. The court found that the issuance of the discount based on the amount of a customer's grocery purchases was a unilateral contract formed with the customer at checkout since the customer anticipated earning a fuel discount each time he/she shopped at a Giant Eagle grocery store.

Unlike in Giant Eagle, however, there is no unilateral contract formed because of the condition precedent that the student remain in school for two weeks to receive the Reduction. The requirement not only required the student to complete and earn Number, but it also required the student to complete attendance for the first two weeks of the following academic term (Taxpayer's subsequent taxable year).

In Giant Eagle, the discount was applied immediately on purchase, distinguishing the contract terms. Thus, the actions required by the student for the unilateral contract to be formed did not occur until the following taxable year.

⁵ The Service will apply the Third Circuit's interpretation of the all-events test only within the Third Circuit (See AOD-2016-03; 2016-40 I.R.B. 424).

This case is also distinguishable from the Pennsylvania case relied on by Giant Eagle. In Cobaugh v. Klick-Lewis, Inc., 385 Pa.Super. 587, 561 A.2d 1248 (1989), a car dealership, promising a discounted car to any golfer hitting a hole-in-one on the ninth tee of a golf course, was required to honor its offer after a hole-in-one was made, notwithstanding the dealership's stated intention to end the promotion a few days prior. Signs were posted that a hole-in-one would win the discounted car. The hole-in-one formed a unilateral contract that had to be honored by the dealership. In the subject case, the _____, which was _____, specifically required not only Number to be earned, but also required the student to complete attendance for the first two weeks of the following academic term. The unilateral contract could not be formed until the student's attendance requirement was completed the following term.

Taxpayer's deduction is analogous to the situation presented in General Dynamics, 481 U.S. at 239. In General Dynamics, the Supreme Court held that the taxpayer was not entitled to deduct additions to reserve accounts reflecting its obligation to reimburse employee medical expenses which, as of the close of the year, had been incurred but not yet submitted for reimbursement on an official claim form. In the Court's view, the filing requirement was "not a mere technicality;" rather, it was a "true condition precedent to liability." Id. at 244 n.5. Stated in terms of the all-events test, "[m]ere receipt of services for which, in some instances, claims will not be submitted does not, in our judgment, constitute the last link in the chain of events creating liability." Id. at 245. In noting that the filing of a claim was not a mere technicality, the Court stated that: "[s]ome covered individuals, through oversight, procrastination, confusion over the coverage provided, or fear of disclosure to the employer of the extent or nature of the services received, might not file claims for reimbursement to which they are plainly entitled." Id. at 244. Since the last event necessary to fix that liability in General Dynamics had not occurred by the end of the tax year, the first prong of the all-events test was not met.

In the subject case, Taxpayer was aware at the end of the tax year as to which students earned Number, but each student still had to complete attendance in the first two weeks of the following academic term. Like the taxpayer in General Dynamics, at year end, Taxpayer's estimated Reductions remained only a potential expense until it became fixed, if at all, on the registration for classes the following term. Obviously, various reasons could arise that a student would not register for classes the next term, including, transferring schools, _____, needing a break, or deciding that school is not worth the expense.⁶

This case is also analogous to Chrysler Corp. v. Commissioner, 436 F.3d 644 (6th Cir., 2006). In Chrysler, the Sixth Circuit held that a vehicle manufacturer's estimated future warranty liability was not fixed by the existence of statutes governing the warranty, but instead by the filing of a valid warranty claim.

⁶ To receive the Reduction,

The court, relying on General Dynamics, reasoned that the vehicle manufacturer's estimated expenses to provide warranty repairs in the future did not become fixed in the years cars were sold, because the last event in the fixing of the liability did not occur until the presenting of a claim for warranty service by one of its dealers or the retail customer. Chrysler, 436 F.3d at 650-651.

Similar to the vehicle manufacturer's reimbursement requirements in Chrysler, Taxpayer had no legal obligation to reduce future tuition at the time Number were earned. In Chrysler and the present case, the anticipated liabilities are contingent on the act of another party, i.e. the student, not the taxpayer, in a subsequent tax year. Here, the Taxpayer is not required to reduce tuition until the student affirmatively registers for classes the following term. Applying the rationale of Chrysler to the facts here, the last event fixing Taxpayer's liability for a Reduction occurs when the student completes the attendance requirement the following term, assuming the other eligibility requirements are satisfied.

The other cases cited to by the Third Circuit in Giant Eagle also are distinguishable. See Hughes Properties, 476 U.S. at 593 (deduction permitted for annual increase in progressive jackpot payoff amounts because the anticipated liability was unconditionally fixed under Nevada law); Gold Coast Hotel & Casino v. United States, 158 F.3d 484 (9th Cir. 1998)(casino could deduct value of slot club points won by slot club member but not yet redeemed because the liability was fixed by state gaming regulations once a member accumulated a certain number of points); Lukens Steel Co. v. Commissioner, 442 F.2d 1131 (3d Cir. 1971) (liability fixed under a collective bargaining agreement requiring taxpayer to make payments to a trust fund to pay supplemental unemployment benefits to taxpayer's employees; the taxpayer's contingent liability could not be canceled); Massachusetts Mutual Life Insurance Co. v. United States, 782 F.3d 1354 (Fed. Cir. 2015) (amount to be paid was absolutely guaranteed, and the only uncertainty at the end of the year was who would ultimately receive the absolutely guaranteed amount). In all these cases, the taxpayer was permitted to deduct a liability where the amount of the liability was unconditionally fixed. The only contingency in these cases was the identity of the individual or individuals who would receive payment from the taxpayer or the point in time when the payment would be made.

Lastly, as an additional argument, we note that Taxpayer had the right to terminate the Program. Taxpayer also had the right if the Program was terminated. The Reduction was not a fixed liability if the Taxpayer had the right to disallow Reductions upon canceling the Program. The Third Circuit in Giant Eagle considered the fact that Giant Eagle could not cancel the rewards points to be important, stating that "none of the published program parameters suggested that Giant Eagle reserved the right to retract rewards that customers had already accrued." Giant Eagle, 822 F.3d at 674. In the present case, Taxpayer had the unilateral right to terminate the Program, and if the Program were terminated, the

Thus, under this alternative argument, Taxpayer again does not satisfy the fixed liability standard under the all-events test.

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Please call (216) 858-7323 if you have any further questions.

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