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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:B07 – PLR-117852-00

Date:

April 12, 2002

LEGEND:

P =

X =

Y =

City =

Dear :

This letter is in response to your request for a ruling that the costs of goods and services made available by Y without charge to its customers and involving the use of facilities operated by third parties on Y's premises (hereinafter "comps"), are deductible without regard to limitations in § 274 of the Internal Revenue Code.

CONCLUSION:

Expenditures for the goods and services (meals, beverages, spa treatments, and show tickets) that Y purchases from its tenants and awards as comps to its patrons in accord with the comp policy and procedures described below are appropriately characterized as expenses for goods, services, and facilities made available by the taxpayer to the general public under § 274(e)(7) and are deductible in full. No opinion is expressed as to the federal income tax consequences of comps appearing on Y's management exception report.

FACTS:

Y, a wholly-owned subsidiary of X, operates a combination resort, hotel, casino, and shopping mall in City. Y does not operate its own restaurants, spa facilities, or entertainment facilities, but leases space for those functions to unrelated third-parties. Y purchases goods and services from its tenants (meals, beverages, spa treatments,

and show tickets) to grant to its patrons as comps. As is the general practice within the casino industry, Y provides these comps to certain patrons who meet specified levels of participation in Y's gaming facility.

Y represents that these comps are granted based on objective criteria designed to measure a patron's gaming activity. Gaming in Y's casino is generally broken into two segments: (1) table games and (2) slot machines. Y uses two, segment-specific, objective methods to determine the amount of comps to which its casino patron is entitled: (1) the table games ratings process, which accumulates data manually via casino employees' observations; and (2) the P process, which accumulates data electronically via use of a plastic card with a magnetic strip. The data from these processes are input to a central repository so that a casino patron receives comps through one integrated system.

Dissemination of Information about the Availability of Comps

Y has created an advertising and marketing strategy intended to inform the general public of the availability of these comps. Direct mail is used to provide informational packets about Y and the manner in which comps are earned. Y advertises the existence of the comp system, and how the system works, to the public through third party magazines. Y's marquee sign displays a variety of marketing and promotional materials 24 hours a day, including information about comps that can be earned. Y's website on the Internet publicizes the availability of comps.

Y employs "casino hosts" (hosts) stationed on the casino floor, to interact with casino patrons and ensure that they understand the comp system. The hosts also telephone to follow up with patrons after departure to ensure that they are informed of how use of the amenities of the casino resort (including goods and services Y purchases from its tenants) can be earned either through the P or the player rating system, or to inform them of unused comp allowances from their previous trip. Casino patrons do not have to use all their comp allowances during the same trip to City in which the comps are earned. Returning casino patrons may be afforded a comp status upon checking into the hotel. They may redeem earned comps through charging their room account for restaurant meals, spa usage and showroom tickets up to a pre-determined amount based upon the earned comp allowances as determined by the casino management system.

Y operates marketing offices in several domestic cities and employs hosts and marketing representatives in several foreign countries. The outlying hosts and marketing personnel are trained in explaining the rating system and P benefits to potential gaming patrons.

Membership in the P

Y advertises membership in the P and explains the P slot machine point system and table games rating system for earning comps. Membership rules are simple: the patron must be 21 years of age; cannot be an employee of Y; and membership must be used once every 12 months. Both slot machine players and table games players may become members of the P. Members receive a plastic card, similar in appearance to a credit card, which serves to electronically record their slot machine play and identifies them for the purposes of the manual monitoring of their table games play. Patrons who are members can earn, depending on their level of play, the described comps.

Y actively encourages membership in P:

- Y distributes membership packages and promotional materials to convention and trade show attendees at an exposition and convention center also located in City;
- Y hands out P membership packets (which contain explanatory brochures and membership cards) at its front desk to all hotel guests as they check in. Additional P membership packets are located in each hotel room. A video service channel on the hotel room's television informs guests about the benefits of membership in P;
- Y places brochures describing the P and its benefits throughout its premises, particularly in the casino, at the cashier's office, and at change booths;
- Y places signage on each slot machine encouraging membership in the P. The slot machines also electronically signal when a patron is not using a P membership card;
- Y's hosts (1) approach patrons who are not members of the P in order to suggest membership to the patron; (2) assist the patron in completing the application to join P and obtaining the membership card for that patron at the P center located on the casino floor without interrupting that patron's gaming activity; and (3) explain the benefits of comps to members of the P;
- Y's marquee sign includes information about the P; and
- Y distributes brochures explaining membership in and the benefits of the P to its potential patrons at the conclusion of daily gaming classes.

Y has created additional incentives, involving special events or comps not described here, for patrons to use the P card and rating system.

Objective Criteria Used to Award Comps

I. Comp Allowances for Wagering at Slot Machines

Comp allowances to patrons wagering at the slot machines are based upon point systems generally administered through membership in the P. A card with a magnetic strip is inserted into the slot machines and electronically records the number of plays or amounts wagered by a particular patron. The number of plays or amounts wagered are converted into points. The points accrue at different rates for different machines, based on the cost of play for that machine.

Patrons can determine their P point totals by simply inquiring at the P member's center located on the casino floor, requesting a statement by mail, making a telephone inquiry, or accessing their account via Y's website on the Internet. Points earned are redeemable into the described comps, among other benefits. If a member of P wants to convert his points into a comp, he notifies a host or an employee staffing the P center located on the casino floor.

II. Comp Allowances for Wagering at Table Games

Comp allowances to patrons wagering at the table games are based upon how much the patron is "rated." "Rated" is the casino term used to signify the measurement of length of time played and average amount wagered by a casino patron per trip to City.

Patrons display their cards to the personnel at the table games to have their play manually rated, but do not have to be members of the P in order to be rated. Supervisory personnel observe the table games on a constant basis to ensure that all casino patrons wagering the minimum amounts are rated. Any table game patron wagering \$25 per hand or more is rated. Patrons wagering lesser amounts are rated upon their request. Each rated patron's name and pertinent information, unless refused to be provided, are entered into the player rating system in the table games area.

The casino uses the length of time that the patron gambles, the average amount wagered by the patron during that period, and a historical win percentage (determined using casino industry data), to calculate the casino's theoretical amount of win. A percentage (which varies from time-to-time based upon competitive factors and profit margin goals) of the casino's theoretical win amount is the monetized comp allowance afforded the table games patron. Upon the request of the patron or invitation by a host or table games supervisor, patrons are given the choice of receiving the described comps or other comps, based upon the monetized comp allowance and the retail values of the comps. The host assists the patron in determining the amount of his or her table games comp allowance and facilitates arranging the patron's use of the comps.

Integrated Comp Tracking System

Although the gaming is rated separately for table games versus slots, a patron receives all his comps through one integrated casino management tracking system. Virtually all

comps granted to casino patrons are entered into the tracking system. The system tracks the patron's comp allowance usage by amount, location, and designating host. It compares these comps to the rated play and points earned.

From this reporting function, comp exception reports are generated. These exception reports are designed to monitor instances of subjective granting of comps to patrons who have not accumulated the necessary points or rated play to justify the comp. The exception reports are reviewed daily by personnel in a central casino comp department. These reports are also frequently reviewed by casino executives and the reports are used as a measurement tool to evaluate staff and their objective implementation of Y's comp procedures.

LAW and ANALYSIS:

Section 274(a)(1)(A) of the Internal Revenue Code provides that no deduction otherwise allowable under Chapter 1 shall be allowed for any item with respect to an activity generally considered to constitute entertainment, amusement, or recreation unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with the active conduct of the taxpayer's trade or business.

Section 274(d) provides, in relevant part, that no deduction is allowed for entertainment expenses unless the taxpayer substantiates, by adequate records or by sufficient evidence corroborating the taxpayer's own statement, the (A) amount, (B) time, (C) place, (D) business purpose, and (E) business relationship to the person or persons entertained.

Section 274(k) provides that no deduction is allowed for any expenditures for food or beverages unless (1) such expense is not lavish nor extravagant under the circumstances, and (2) the taxpayer is present at the furnishing of such food or beverages.

Section 274(n) generally provides that the amount allowable as a deduction for (A) any expense for food or beverages, and (B) any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement or recreation shall not exceed 50 percent of the amount of such expense or item otherwise deductible.

Section 274(e)(7) provides an exception for expenses incurred for goods, services, and facilities made available by the taxpayer to the general public. If subsection (e)(7) of § 274 is applicable, those expenditures are exempt from the rules requiring that entertainment and meal costs meet either the "directly related" or "associated with" tests, as well as the substantiation rules contained in § 274(d), the rules relating to meals contained in § 274(k), and the rules limiting the overall amount of an otherwise allowable deduction contained in § 274(n). See, §§ 1.274-5T(c)(7); 274(k)(2); 274(n)(2)(A).

Television shows, radio broadcasts, newspaper articles, and the like are examples of expenditures for the entertainment of the general public. Section 1.274-2(f)(2)(viii). Distributing product samples or making private facilities available for public use also come within this exception. Id. Promotional items, e.g., tickets to a baseball game which are provided to the first 50 people who visit a hardware store on a particular date, or who purchase an item from the store during a sale, have been characterized as items that are made available to the general public. H.R. Rep. No. 426, 99th Cong., 1st Sess. (1986), reprinted in 1986-3 (Vol. 2) C.B. 1, 124, and S. Rep. No. 313, 99th Cong., 2d Sess. (1986), reprinted in 1986-3 (Vol. 3) C.B. 1, 72.

In Sullivan v. Commissioner, T.C. Memo 1982-150 (decided before § 274(n) was enacted), the taxpayer discontinued giving S & H green stamps and began offering free beer to his customers as a promotional item. Five percent of the beer was consumed by Mr. Sullivan's employees and was exempted from the operation of § 274 under the former § 274(e)(2) exception for expenses for food or beverages furnished on the business premises of the taxpayer primarily for his employees. The court found that Sullivan was not attempting to generate mere general goodwill by making the beer available to his customers; he was specifically trying to sell more of his product. Therefore, the remaining 95% of the costs of the beer was also deductible in full.

An example of goods, services, or facilities made available to the general public is promotional activities. When § 274(e)(7) was enacted in 1962, the pertinent committee reports contained the following: "Expenses of distributing samples to the general public would also come within this exception." H.R. Rep. No. 1447, 87th Cong., 2d Sess. (1962), reprinted in 1962-3 C.B. 429, and S. Rep. No. 1881, 87th Cong., 2d Sess. (1962), reprinted in 1962-3 C.B. 743. When enacting § 274(n) in 1986, Congress equated promotional activities with samples:

[T]he reduction rule does not apply in the case of items, such as samples and promotional activities, that are made available to the general public. For example, if the owner of a hardware store advertises that tickets to a baseball game will be provided to the first 50 people who visit the store on a particular date, or who purchase an item from the store during a sale, then the full amount of the face value of the tickets is deductible by the owner.

H.R. Rep. No. 426, 99th Cong., 1st Sess. (1986), reprinted in 1986-3 (Vol. 2) C.B. 1, 124, and S. Rep. No. 313, 99th Cong., 2d Sess. (1986), reprinted in 1986-3 (Vol. 3) C.B. 1, 72.

The term "promotional activities" is not defined in the Code or the Regulations. However, the legislative history and case law discussed above support treating the comps purchased from unrelated third parties as promotional items satisfying the requirements of § 274(e)(7).

The taxpayer's representations regarding the manner in which these comps are marketed and awarded show that they are made available to the general public.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Associate Chief Counsel
(Income Tax & Accounting)

By: _____
George B. Baker
Chief, Branch 7