

Office of Chief Counsel
Internal Revenue Service
Memorandum

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from: Thomas D. Moffitt
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subject:

This Chief Counsel Advice responds to your request for assistance dated December 12, 2007. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

x percent =

Consumer Products =

ISSUE

Whether Taxpayer's method of accounting for its cash rebate liability is permitted under § 1.461-4(g)(3) of the Income Tax Regulations.

CONCLUSION

Taxpayer's method of accounting for its cash rebate liability is not permitted under § 1.461-4(g)(3).

FACTS

Taxpayer is a retailer of consumer products. Taxpayer uses an accrual method of accounting. Taxpayer has a cash rebate program which involves the issuance of cash rebate offers with the sale of a product. Under the cash rebate program, the customer pays full price for the product at checkout, but receives a rebate offer for a stated amount. If the customer timely submits a properly completed form requesting a rebate (and otherwise complies with the terms of the rebate offer), Taxpayer will issue the customer a check in the amount of the rebate offer.

Based on experience, Taxpayer estimates that it pays or redeems only \underline{x} percent of the total rebate offers. For financial accounting and federal tax accounting purposes, Taxpayer does not record the full purchase price as income at the time of the sale, even though it receives full price at that time. Rather, Taxpayer reduces its gross receipts by the amount of its estimated rebate payment (\underline{x} percent of the face amount of the rebate offer).

If a rebate expires, Taxpayer reverses the prior reduction from gross receipts by bringing back into income the amount of its previously estimated rebate payment. This reversing entry does not occur until several months after the expiration date, to allow for dispute resolution.

If a rebate request is properly submitted, Taxpayer issues the customer a check for the full face amount of the rebate offer. When the customer cashes the check, Taxpayer reduces gross receipts by an amount equal to the difference between the face amount of the rebate offer and Taxpayer's earlier estimated rebate payment. This entry often occurs several months after a rebate request is properly submitted.

LAW AND ANALYSIS

Section 1.461-4(g)(3) specifically controls the treatment of all cash rebates

Section 461(a) of the Internal Revenue Code provides that the amount of any deduction or credit must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(h) and § 1.461-1(a)(2)(i) of the Income Tax Regulations provide that, under an accrual method of accounting, a liability is incurred, and is generally taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that (1) establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred

with respect to the liability. See also § 1.446-1(c)(1)(ii)(A). Section 461(h)(1) provides that the all events test is not met any earlier than when economic performance occurs.

The Service issued final regulations addressing payment liabilities under § 461(h) effective for years after December 31, 1991. Section 1.461-4(g)(3) provides that if the liability of the taxpayer is to pay a rebate, refund, or similar payment to another person (whether paid in property, money, or as a reduction in the price of goods to be provided in the future by the taxpayer), economic performance occurs as payment is made to the person to which the liability is owed. This subparagraph (g)(3) applies to *all* rebates, refunds, and payments or transfers in the nature of a rebate or refund regardless of whether they are characterized as a deduction from gross income, an adjustment to gross receipts or total sales, or an adjustment or addition to costs of goods sold.

The preamble to the economic performance regulations provides:

In prescribing rules for the listed payment liabilities [those under § 1.461-4(g)], other than liabilities arising under a workers compensation act or out of any tort, the Service exercised its broad regulatory authority provided by section 461(h). Section 461(h)(2)(D) authorizes the Secretary to issue regulations that determine the time for economic performance in the case of liabilities for which section 461(h) does not expressly provide rules. Moreover, section 461(h)(2) authorizes the Secretary to issue regulations that change the time for economic performance in the case of liabilities for which section 461(d)(2) expressly provides rules. Thus, the final regulations retain the payment rule for the liabilities in § 1.461-4(g).

T.D. 8408, 1992-1 C.B. 155, 159. The preamble further states at 160:

Rebates and Refunds

The proposed regulations provide that if the liability of a taxpayer is to pay a rebate or refund to another person, economic performance occurs as payment is made to the person to which the liability is owed. Because payment provides the most objective evidence of economic performance for a rebate or refund, this rule provides certainty for taxpayers and is administrable by the Service....

For its cash rebate program, Taxpayer does not record the full purchase price as income at the time of the sale, even though it receives full price at that time. Rather, Taxpayer reduces its gross receipts by the amount of its estimated rebate payment (x percent of the face amount of the rebate offer). Taxpayer's use of this method of accounting is specifically prohibited by § 1.461-4(g)(3). Under the specific requirements of § 1.461-4(g)(3), Taxpayer may not treat its liability for a cash rebate as incurred prior to payment of that cash rebate.

Taxpayer's cash rebates are not premium coupons

Despite the clear language of § 1.461-4(g)(3), Taxpayer argues that it may account for rebates under § 1.451-4. Section 1.451-4(a)(1) provides that if an accrual

method taxpayer issues trading stamps or premium coupons with sales, and such stamps or coupons are redeemable by such taxpayer in merchandise, cash or other property, the taxpayer should, in computing the income from such sales, subtract from gross receipts an amount equal to (i) the cost to the taxpayer of merchandise, cash, and other property used for redemptions in the taxable year and (ii) the net addition to the provision for future redemptions during the taxable year (or less the net subtraction from the provision for future redemptions during the taxable year).

Under Taxpayer's cash rebate program, the customer pays full price for the product at checkout, but receives a cash rebate offer for a stated amount. Such a single-coupon rebate is a "discount coupon" and not ordinarily considered a "premium coupon" (or trading stamp) within the meaning of § 1.451-4. "Ordinarily, a discount coupon is individually redeemable, while the premium coupon [under § 1.451-4] is intended to be collected and redeemed in large numbers for a single product." Staff of the Joint Committee on Taxation, General Explanation of the Revenue Act of 1978, 95th Cong., 2d Sess. 244 (1978), discussing § 466 (later repealed by the Tax Reform Act of 1986), which provided a method of accounting for qualified discount coupons. Section 466 distinguished discount coupons from premium coupons under 1.451-4. Taxpayer's cash rebates are discount coupons, not premium coupons. Because Taxpayer's cash rebates are discount coupons, Taxpayer is not eligible to use the method of accounting provided in § 1.451-4 for premium coupons.

Texas Instruments does not control the treatment of Taxpayer's cash rebates

In a case involving tax years 1981 through 1983 with similarities to the Taxpayer's cash rebate sales incentive program, the Tax Court permitted a taxpayer to use § 1.451-4. Texas Instruments, Inc. v. Commissioner, T.C. Memo. 1992-306. One of the rebate programs offered by Texas Instruments was the home computer rebate program, under which Texas Instruments offered a cash rebate on home computers purchased by retail customers. Under the program, Texas Instruments would pay the rebate if proof of purchase, including a sales receipt, was submitted within a fixed period of time after the sale occurred. The Tax Court concluded that the proofs of purchase that Texas Instruments issued with sales, and which were required to be submitted to Texas Instruments to entitle consumers to a rebate, were "coupons" within the meaning of § 1.451-4.

Texas Instruments is inapposite to this case. The distinction between a discount coupon and a premium coupon was not at issue in Texas Instruments. The opinion predated the economic performance rules, and does not address current law. Therefore, the opinion is not precedent on the definition of discount coupons.

Clearly, § 1.461-4(g)(3) controls this case. Section 1.461-4(g)(3) is an expression of Treasury's broad regulatory authority, applies to all rebates, and provides the payment rule -- the most objective evidence of economic performance for a rebate. Taxpayer's method of accounting is not in compliance with § 1.461-4(g)(3).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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Please call (202) 622-7900 if you have any further questions.

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