

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

Number: **202417021**

Release Date: 4/26/2024

CC:ITA:B03:JRGrill

POSTS-107600-22

UILC: 461.01-00, 461.06-01

date: April 24, 2024

to: Gwen H. Schoen  
Senior Counsel, Area 5  
(Large Business & International)

from: Ronald J. Goldstein  
Senior Technician Reviewer, Branch 2  
(Income Tax & Accounting)

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subject: Credit Card Reward Liabilities Under I.R.C. Section 461

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

ISSUES

1. When do credit card reward liabilities become fixed and determinable under § 461?<sup>1</sup>
2. When does economic performance occur under § 461(h) for credit card reward liabilities?
3. Can a taxpayer adopt the recurring item exception under Treas. Reg. § 1.461-5 with regard to credit card reward liabilities?

CONCLUSIONS

1. Credit card reward liabilities become fixed and determinable under § 461 when the cardholder has the right to redeem the rewards for cash or a statement credit.

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<sup>1</sup> Unless otherwise indicated, all section references refer to the Internal Revenue Code, and all regulation sections refer to the Income Tax Regulations.

2. Economic performance occurs under § 461(h) and Treas. Reg. § 1.461-4(g)(3) when reward payments are made to the cardholder in the form of cash, a statement credit, or other goods or services.
3. Credit card issuers may adopt the recurring item exception under Treas. Reg. § 1.461-5 to deduct reward liabilities in the year that they become fixed and determinable, provided that the rewards are redeemed by the cardholder within 8 ½ months after the close of that taxable year.

### BACKGROUND

Many industries employ reward programs to encourage consumers to buy or use their products. Each reward program operates slightly differently based on the industry and applicable user agreement. This memorandum addresses credit card issuers, such as banks, that operate reward programs to incentivize cardholders to use their credit cards to pay for new purchases. These reward programs sometimes differ in the manner in which rewards are earned, computed, or redeemed; however, credit card reward programs are generally point based. For example, reward programs may provide varying amounts of reward points based on the purchase category, require a minimum amount of points to accrue before redemption, or permit the cardholder to redeem their reward points at any time. In addition, some credit card issuers permit the cardholder to redeem their rewards for cash or a statement credit while others may also permit the cardholder to redeem their rewards for goods or services.

### FACTS

For purposes of this memorandum assume Taxpayer is a federally chartered bank that issues credit cards to cardholders which allow the cardholders to access revolving lines of credit to make purchases of goods and services and to obtain cash advances. Taxpayer allows its cardholders to earn rewards by accumulating miles, points, or cash that can then be redeemed for cash, statement credits, travel, gift cards to third party vendors, and other goods and services (“credit card rewards” or “rewards”). Cardholders may redeem their rewards through contacting the bank directly by phone, or going through the bank’s website or mobile app (all redemption methods hereinafter collectively referred to as “app”). Taxpayer’s reward program does not have redemption thresholds, and rewards are redeemable immediately upon receipt at the close of the cardholder’s billing period without an additional purchase required.

As relevant here, a cardholder can earn different amounts of points, i.e., 1, 2, or 3 points per dollar charged, based on the transaction category, i.e., gas, restaurant, travel, etc. Each point is valued at \$.01 for redemption purposes, and a cardholder may use Taxpayer’s app to request a redemption of reward points by inputting the number of points that the cardholder wishes to redeem and clicking the “redeem” button to execute the redemption. Immediately upon clicking the “redeem” button on the app, Taxpayer makes the redemption payment by sending the cardholder a check, issuing a statement credit, or providing the cardholder with the selected reward benefit. At the same time,

the cardholder's total points available for redemption are reduced by the number of points redeemed.

Taxpayer currently deducts the liability that it incurs for its credit card rewards when the rewards are redeemed. However, Taxpayer would like to adopt via an accounting method change the recurring item exception and deduct the liability for credit card reward expenses in the taxable year that the rewards are earned by its cardholders, provided that the rewards are redeemed within 8 ½ months after the end of the taxable year.

### LAW AND ANALYSIS

Section 461(a) of the Internal Revenue Code provides that, in general, the amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income. Under an accrual method of accounting, a liability (as defined in Treas. Reg. § 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Section 461(h); Treas. Reg. § 1.461-1(a)(2).

#### All-Events Test

Generally, for purposes of establishing the fact of a liability, a taxpayer may not "deduct an estimate of an anticipated expense, no matter how statistically certain, 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); compare with United States v. Hughes Properties, Inc., 476 U.S. 593, 602-03 (1986) (casino jackpot liability was unconditionally fixed under Nevada law); Gold Coast Hotel & Casino v. United States, 158 F.3d 484, 488-89 (9th Cir. 1998) (casino points liability was fixed and unconditional under state gaming regulations once a member accumulated the minimum number of points). In accordance with General Dynamics, the Service's longstanding position is that all the events have not occurred to establish the fact of a liability if there is a condition precedent that is not ministerial. A requirement that a customer must make an additional purchase to redeem a reward is a condition precedent that is not a ministerial act and results in a reward liability not being fixed for purposes of the first prong of the all-events test.

The issue of reward payments was most recently considered by the Third Circuit, which ruled that a taxpayer's anticipated liability for unredeemed gasoline discounts was fixed in the year earned for purposes of the all-events test. Giant Eagle, Inc. v. Commissioner, 822 F.3d 666 (3rd Cir. 2016), rev'g T.C. Memo 2014-146. The liability in Giant Eagle involved a gasoline discount program that entitled a customer to receive a "discount coupon" for a 10 cents per gallon reduction in price for every \$50 spent on

groceries. However, the discount coupons required an additional purchase of gasoline, were only valid at certain gas stations, and they expired three months after the last day of the month in which they were issued. The IRS disagrees with the Third Circuit's decision and issued an Action on Decision ("AOD") that reiterated the Service's position that a "taxpayer's liability for its unredeemed discount coupons is not fixed before the customer purchases the fuel" because the additional purchase of gasoline is not a ministerial act and is, therefore, a condition precedent to the establishment of the liability in accordance with General Dynamics. AOD-2016-03 (2017), I.R.B. 2016-40.

In light of this position and because the credit card rewards at issue are immediately redeemable for a predetermined amount of cash or a statement credit, there is no condition precedent, notwithstanding the fact that customers' rewards may also be redeemed for goods or services. In contrast, reward programs that do not provide redemption options that include cash or a statement credit but require an additional purchase to receive a partial or complete discount have a condition precedent such that the accrued reward liabilities are not fixed for purposes of the all-events test until the rewards are actually redeemed.<sup>2</sup>

We conclude, consistent with the Service's longstanding position and the Giant Eagle AOD, that the credit card reward liabilities discussed above are fixed to establish the fact of the liability and the amounts determinable when they become redeemable for cash or a statement credit because there is no additional purchase required to redeem the rewards. The credit card rewards program at issue is distinguishable from General Dynamics because a cardholder's right to redemption for cash or a statement credit is fixed and the redemption act is ministerial, versus the condition precedent—claim submission and approval—present in General Dynamics. Likewise, the program at issue is distinguishable from Giant Eagle because cardholders are not required to make an additional purchase of gasoline at specific locations within a limited time period to receive the reward benefit.

### Economic Performance

For purposes of determining whether an accrual basis taxpayer can treat the amount of any liability (as defined in Treas. Reg. § 1.446-1(c)(1)(ii)(B)) as incurred, the all-events test is not treated as met any earlier than the taxable year in which economic performance occurs with respect to the liability. I.R.C. § 461(h); Treas. Reg. § 1.461-4(a)(1).<sup>3</sup> If the liability of a taxpayer is to pay a rebate, refund, or similar payment to

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<sup>2</sup> Taxpayers operating reward programs where the liabilities are not fixed until redemption have not satisfied the all-events test and are, therefore, not eligible for the recurring item exception discussed infra.

<sup>3</sup> Taxpayers with reward programs that allow a cardmember to receive a partial or full discount on the purchase of an item are issuers of "hybrid coupons" subject to the all-events test and economic performance requirement provided in § 461(h). See AM 2017-002 discussing premium, discount, and hybrid coupons. Treas. Reg. § 1.451-4 provides an exception to the all-events test and § 461(h) for issuers of "trading stamps" and "premium coupons." Taxpayer is not eligible for the § 1.451-4 exception because the credit card rewards are "hybrid coupons."

another person (whether paid in property, money, or as a reduction in the price of goods or services to be provided in the future by the taxpayer), economic performance occurs when payment is made to the person to which the liability is owed. Treas. Reg. § 1.461-4(g)(3) and (8), Example 2.

We conclude that Taxpayer's credit card rewards that are redeemable for cash, a statement credit, or other goods or services are a rebate, refund, or similar payment for purposes of Treas. Reg. § 1.461-4(g)(3). A rebate is generally a return of an amount actually paid by a customer in a sale. Under credit card reward programs, the cardholder receives cash back or other rewards as a result of making purchases with the credit card in an amount determined by the purchase price. While the rewards do not technically constitute a rebate, they are sufficiently similar to a rebate to constitute a "similar payment" under Treas. Reg. § 1.461-4(g)(3). Accordingly, for Taxpayer's credit card rewards, economic performance for purposes of the all-events test is satisfied under Treas. Reg. § 1.461-4(g)(3) when the redemption payment is made.

#### Recurring Item Exception

Section 461(h)(3) and Treas. Reg. § 1.461-5 allow a taxpayer to treat a liability as incurred prior to economic performance occurring by adopting the recurring item exception as a method of accounting for recurring items under certain circumstances. Treas. Reg. § 1.461-5(b) provides that a liability is treated as incurred for a taxable year if (1) as of the end of the taxable year, all events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy; (2) economic performance occurs on or before either the earlier of the date the taxpayer files a timely (including extensions) filed return or the 15th day of the 9th month after the close of that taxable year; (3) the liability is recurring in nature; and (4) either the amount of the liability is not material, or the accrual of the liability for that taxable year results in a better matching of the liability with the income to which it relates than would result from accruing the liability for the taxable year in which economic performance occurs. Treas. Reg. § 1.461-5(b)(5)(ii) provides that for liabilities subject to Treas. Reg. § 1.461-4(g)(3), such as rebates and refunds, the matching requirement of Treas. Reg. § 1.461-5(b)(1)(iv)(B) is deemed to be satisfied.

We conclude that Taxpayer's credit card rewards are eligible for the recurring item exception set forth in Treas. Reg. § 1.461-5 because the liability is fixed and determinable, recurring in nature, and the accrual of the liability for that taxable year results in a better matching of the liability with the income to which it relates. Taxpayer may, therefore, satisfy the all-events test where economic performance, i.e., payment on redemption, occurs on or before either the earlier of the date Taxpayer files a timely return (including extensions) or the 15th day of the 9th month after the close of that taxable year.

Please call Justin Grill at (202) 317-5100 if you have any further questions.