

## Deferral of Gift Card Income; Rev Proc 2011-18

The IRS released a new Revenue Procedure which expands the opportunity to defer income for sellers of gift cards. Reversing its earlier position that deferral was only appropriate where the gift card was redeemable for goods or services provided by the seller, the IRS now recognizes that the deferral for receipt of advanced payments may be used in some cases where the cards may be redeemed for goods or services of a third party.

The accrual method of accounting requires income to be recognized when all events that fix the right to receive the income have occurred. That is defined as the earliest of the time performance takes place, payment is due, or payment is received. For prepaid gift cards the test would be met when payment is received.

Nevertheless, recognition of income on advanced payments for goods and some services could be deferred until the end of the second year following the year of receipt, if the payment was not earned in the year received. However, in no event was a taxpayer allowed to delay recognition beyond the period in which income was recognized for financial reporting.

Under a 2004 Revenue Procedure only the sale of a gift card redeemable by the *same* retailer selling it could qualify for the deferral. A sale of a gift card redeemable by *another* retailer was not deferrable. Income was recognized upon receipt where a third party was obligated to provide the associated goods or services. The nature of gift card transactions has changed considerably since 2004. Some of the types of structures that have evolved are listed in the block to the right. Without this ruling, none of the issuers of gift cards under these new plans would have been eligible for deferral.

With Rev Proc 2011-18 the IRS recognizes that the changing use of gift cards requires a change in approach.

### Common Third Party Gift Card Transactions:

Members of an affiliated group of corporations may establish a gift card subsidiary to sell gift cards redeemable for goods or services provided by the gift card subsidiary or other members of the affiliated group;

A franchisor, purchasing cooperative, not-for-profit membership organization, or franchisee may sell gift cards redeemable for goods or services provided by independently-owned franchisees or members;

A restaurant management company may sell gift cards redeemable by participating restaurants in different geographic locations or with different trade names; or

A retailer's gift card is redeemable for merchandise at stores it operates, as well as those operated by a related party or by unrelated parties.



Effective for tax years ending on or after December 31, 2010, taxpayers that sell gift cards otherwise meeting the requirements of Rev. Proc. 2004-34 may be allowed to defer recognition if the sale qualifies as an “eligible gift card sale.” A gift card sale is eligible if: 1) The taxpayer is primarily liable to the customer (or gift card holder) for the value of the card until redemption or expiration; and 2) The gift card is redeemable by the taxpayer or by any other entity that is legally obligated to the taxpayer to accept the gift card as payment for any of the goods or services listed in Rev. Proc. 2004-34 Sec. 4.01(3). (E.g. goods, services, use of intellectual property.)

**A gift card sale is eligible if:**

1. The taxpayer is primarily liable to the customer (or gift card holder) for the value of the card until redemption or expiration; and
2. The gift card is redeemable by the taxpayer or by any other entity that is legally obligated to the taxpayer to accept the gift card as payment for any of the goods or services listed in Rev. Proc. 2004-34 Sec. 4.01(3). (E.g. goods, services, use of intellectual property.)

In addition, the IRS will no longer raise the issue of whether the deferral method applies to eligible gift card sales that previously would not have qualified for years ending prior to December 31, 2010. Furthermore they have said that if the issue is under consideration in exam, appeals or before the U.S. Tax Court the IRS will not pursue the issue further.

Taxpayers who have not utilized the deferral in situations that now qualify will be able to employ the automatic consent procedure presented in Rev. Proc. 2011-18 to request a change in accounting method. Changes in accounting methods require that requests be filed with the Service using Form 3115. Automatic changes may be filed by the due date of

the return for which the request is made, including extensions and do not require an application fee. This should allow ample time for taxpayers to review their gift card arrangements and determine if changing their method of accounting would be beneficial.

Please feel free to contact us with any questions you may have on the changes to the gift card deferral rules.

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