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State and Local Advisory Council Sales Price Definition – Employee Points Program

Background

On June 29, 2009, Ms. Loren Chumley filed the interpretation of definition request, RI09007 with the Compliance Review and Interpretations Committee (CRIC). On August 13, 2009, CRIC voted to recommend interpretative opinion 2009-05, IO09005, to the Governing Board. On September 30, 2009, motions to adopt CRIC's recommendation for interpretation of the definition of sales price failed. RI09007 and IO09005 were assigned to the State and Local Advisory Council (SLAC) to research further, seek input, and develop recommendation for further consideration by CRIC.

On October 7, 2009, Sherry Harrell held an open discussion call regarding the employee points program and sales price interpretation to give SLAC members and Ms. Chumley an opportunity to ask questions. On October 26, 2009, Ms. Chumley provided a written response, SL09074, to questions received from SLAC members regarding the employee points program. On October 27, 2009, Ms. Chumley reviewed SL09074 with SLAC members during a SLAC teleconference. SLAC members had additional questions and Ms. Chumley agreed to provide the additional information. On February 14, 2010, Ms. Chumley provided an email response, SL10012, to the second set of additional questions from SLAC members. A revised summary of facts has been prepared from the additional information provided by Ms. Chumley in response to questions from SLAC members during the October 7th and 27th teleconferences.

As a result of the discussion with SLAC members, Ms. Chumley revised the issues for interpretation. The attached paper includes the five issues raised by Ms. Chumley regarding the interpretation of the definition of sales price.

Agreement Provisions

The Streamlined Sales and Use Tax Agreement, Appendix C, Part I, defines "Sales price" as follows:

"Sales price" applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

- A. The seller's cost of the property sold;
- B. The cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
- C. Charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;

- D. Delivery charges;
- E. Installation charges; and
- F. Credit for any trade-in, as determined by state law.

“Sales price” shall not include:

- A. Discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;
- B. Interest, financing, and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale or similar document given to the purchaser; and
- C. Any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale or similar document given to the purchaser.

“Sales price” shall include consideration received by the seller from third parties if:

- A. The seller actually receives consideration from a party other than the purchaser and the consideration is directly related to a price reduction or discount on the sale;
- B. The seller has an obligation to pass the price reduction or discount through to the purchaser;
- C. The amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and
- D. One of the following criteria is met:
 - 1. The purchaser presents a coupon, certificate or other documentation to the seller to claim a price reduction or discount where the coupon, certificate or documentation is authorized, distributed or granted by a third party with the understanding that the third party will reimburse any seller to whom the coupon, certificate or documentation is presented;
 - 2. The purchaser identifies himself or herself to the seller as a member of a group or organization entitled to a price reduction or discount (a “preferred customer” card that is available to any patron does not constitute membership in such a group), or
 - 3. The price reduction or discount is identified as a third party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate or other documentation presented by the purchaser.

States may also exclude from “sales price” either employee discounts that are reimbursed by a third party on sales of motor vehicles, or manufacturer rebates on motor vehicles, or both.

Summary of Facts

Client owns and franchises store locations worldwide and has locations in all of the SST member states. Client sells services and tangible personal property (“TPP”) at its store locations.

Client is starting a program to sell TPP through catalogs and its Website. At this time, the TPP generally consists of tools used in delivering services to customers but Client expects to expand the TPP offerings. Employees, franchisees and the general public may make purchases from Client through a catalog or through the Client’s Website on the internet. Client purchases the inventory on a resale certificate.

Client has implemented an Employee Points Program that serves as an incentive for employees to reach specific goals set by Client’s management. A store is given monthly quotas for “total

sales” (total sales equals sales of services and tangible personal property combined) and “total TPP sales” (total TPP sales equals sales of tangible personal property only).

If a store exceeds its total sales quota, an employee will receive one bonus point for every dollar of sales that the employee made that month. If a store exceeds its “total TPP sales” the employee will receive one bonus point for every dollar of sales that the employee made that month. If a store employee exceeds both total sales AND total TPP sales, the employee will receive double the amount of every dollar of sales that the employee made that month. If the store does not exceed either quota, no bonus points will be received.

If a store exceeds the quota for “total sales” the store manager will receive one bonus point for every dollar of the store does in total sales. If a store exceeds the quota for TPP sales, the store manager will receive four bonus points for every dollar of total TPP sales. If the store does not exceed either quota, no bonus points will be received.

A liability is placed on the books of the company at .005 per point. If an employee leaves the company, the employee forfeits all rights to the points and the accrual is reduced. An employee is not permitted to transfer points.

The points accumulated by each employee may be redeemed for cash, travel, or discounts on purchases of TPP sold through catalog or the Website. Neither franchisees nor members of the general public are allowed to purchase or discount TPP (tools) through the use of points.

Redeeming Points for Cash

Client operates retail concepts under different brand names. Only store managers for two of Client’s brand concepts are eligible to redeem points for cash. Store managers at all other retail concepts are not permitted to redeem points for cash. Employees who are not at a manager level at these stores are not entitled to redeem points for cash. Neither managers nor employees at other brand concepts are permitted to redeem points for cash. Non-manager level employees are never permitted to redeem points for cash. The amount of payments to store managers when points are redeemed for cash is included in the employee’s W-2 for federal income tax purposes.

Redeeming Points for Travel

As mentioned above, employees may redeem the points for travel that is arranged by the Client. Client is not in the travel business. Employees may not purchase travel from third parties – but instead may only use the points to defray the costs of participating in a Client-arranged travel excursion. Example: Client purchases from travel company a cruise for 50 people. Client awards top employees with the trip and gives employees option of using points to have spouse accompany employee on cruise. When points are redeemed in this manner, the points are included in the employee’s W-2 for federal income tax purposes.

Redeeming Points for Discounts of TPP

An employee may use points to discount the regular price of a tool as shown on the catalog or Website. The points are only available to discount the purchase price of TPP from Client’s Website or catalog. Client does not receive consideration from a third party as reimbursement for the discount. Depending on the number of points that an employee redeems, the price could be partially discounted or could be reduced to zero. The value of the points is consistent across the range of products available for point redemption. When an employee uses points to discount the price of TPP from the

Client's Website or catalog, there are no federal income tax implications for the employee and the points are NOT included in the W-2 wages of the employee.

Employees, franchisees and members of the general public use the same Website and catalog for purchasing goods from Client. There is a different price list for members of the general public, for employees and for franchisors. The billing system for purchases by employees is the same system that is used for purchases from franchisors and members of the public.

Client charges a separately stated fee for delivery of the TPP. In some cases, the Client may permit an employee to offset the delivery charge by use of the points. In other words, if a tool is \$100 and the delivery charge is \$10, an employee could use points to offset the \$100 but would still have to pay \$10 for delivery of the TPP. In some cases, an employee could use points to offset both the \$100 plus the \$10 delivery charge, in which case the price paid by the employee would be \$0.

For purposes of this interpretation request, assume that no entity-based, product or use-based exemptions exist with respect to the purchases of TPP. For purposes of this interpretation request, assume that no services are necessary to complete the sale, no installation charges are made and no trade-in credit is applicable.

Issues:

- 1) Do the points redeemed by the employee constitute consideration for the sales transaction?
- 2) Should the points redeemed by the employee be considered a discount in sales price in the sales transaction?
- 3) Are the points which are allowed by the Client and taken by the employee on the sale considered a discount that is excluded from the sales price of the TPP?
- 4) If the sale is made in a member state that includes delivery charges in the definition of the sales price, is the measure of the tax base subject to sales tax equal to the discounted charge for the TPP (which could be zero) plus the delivery charge (which could be zero)?
- 5) If the sale is made in a member state that excludes delivery charge from the definition of the sales price, and the state does not separately tax delivery charges as a service, is the measure of the tax base subject to sales tax equal to the discounted charge for the TPP (which could be zero)?

Alternatives Considered:

Note: The treatment under each option is based solely on the facts provided. The answer may differ with a change in facts.

Option 1

- 1) Employee points that are redeemed on the published price of TPP sold by their employer do not constitute consideration for the sales transaction.
- 2) Employee points that are redeemed on the published price of TPP sold by an employer are considered a discount for purposes of applying the sales price definition in the sales

transaction. The seller does not receive consideration from a third party as reimbursement for the discount.

- 3) The points that are allowed by the Client and taken by the employee as a reduction to the published price of the TPP are considered a discount excluded from the sales price of the TPP.
- 4) If the sale is made in a member state that includes delivery charges in the definition of the sales price, the measure of the tax base subject to sales tax is equal to the discounted charge for the TPP (which could be zero) plus the delivery charge (which could be zero).
- 5) If the sale is made in a member state that excludes delivery charges from the definition of the sales price, and does not separately tax delivery charges as a service, the measure of the tax base subject to sales tax is equal to the discounted charge for the TPP (which could be zero) excluding any separately itemized delivery charges.

Note: Option 1 paragraphs 3, 4, and 5 represents CRIC interpretive opinion prior to SLAC's assignment to research and obtain additional information. Paragraphs 1 and 2 were added as a result of Ms. Chumley's adding 2 issues to the original interpretation request. Paragraphs 1 and 2 are intended to be consistent with CRIC's original interpretation.

Option 2

- 1) The cash equivalent of the employee points applied to the purchase price of TPP is consideration which is included in sales price. Points for which there is no option to convert to cash are not consideration toward the purchase of the TPP
- 2) Employee points redeemed toward the purchase of TPP by employees that cannot be converted to cash are not consideration and are not included in sales price as the term is defined in the agreement.

Employee points redeemed toward the purchase of TPP by employees that are eligible to redeem points for cash are consideration that is included in sales price.

- 3) The points that are allowed by the Client and taken by the employee as a reduction to the published price of the TPP are excluded from the sales price of the TPP if the employee points are not also available for redemption for cash by the employee.
- 4) When the employee points are not also eligible for redemption for cash, and the sale is made in a member state that includes delivery charges in the definition of the sales price, the measure of the tax base subject to sales tax is equal to the amount paid in cash or credit by the employee for the TPP (which could be zero) plus the delivery charge (which could be zero).

When the employee points are eligible for redemption for cash, and the sale is made in a member state that includes delivery charges in the definition of the sales price, the measure of the tax base subject to sales tax is equal to the amount paid in cash/credit plus the cash value of the points redeemed for the TPP plus the delivery charge. The cash equivalent of the employee points redeemed for the purchase price of the TPP is part of the "total amount of the consideration for which the personal property is sold, valued in money, whether received in money or otherwise."

- 5) When the employee points are not also eligible for redemption for cash, and the sale is made in a member state that excludes delivery charge from the definition of the sales price, and does not separately tax delivery charges as a service, the measure of the tax base subject to sales tax is equal to the amount paid in cash or credit by the employee for the TPP (which could be zero) excluding any separately itemized delivery charges.

When the employee points are eligible for redemption for cash, and the sale is made in a member state that excludes delivery charges from the definition of the sales price, and does not separately tax delivery charges as a service, the measure of the tax base subject to sales tax is equal to the amount paid in cash/credit plus the cash value of the points redeemed for the TPP excluding any separately itemized delivery charges. The cash equivalent of the employee points redeemed for the purchase price of the TPP is part of the “total amount of the consideration for which the personal property is sold, valued in money, whether received in money or otherwise.”

Option 3

- 1) Employee points that are awarded or earned in return for job performance or meeting certain goals constitute consideration under the definition of sales price.
- 2) Employee points that are awarded or earned in return for job performance or meeting certain goals and which are redeemed do not constitute a discount.
- 3) Employee points that are awarded or earned in return for job performance or meeting certain goals and which are redeemed do not constitute a discount that may be excluded from the sales price.
- 4) When employee points that are awarded or earned in return for job performance or meeting certain goals are redeemed in a member state that includes delivery charges in the definition of sales price, the measure subject to sales tax is equal to the total amount paid in cash, credit, points, or other consideration by the employee for the TPP plus the delivery charge.
- 5) When employee points that are awarded or earned in return for job performance or meeting certain goals are redeemed in a member state that excludes delivery charges from the definition of sales price and does not separately tax delivery charges as a service, the measure subject to sales tax is equal to the total amount paid in cash, credit, points, or other consideration by the employee for the TPP excluding any separately itemized delivery charges.

Survey

On July 28, 2010 SLAC sent a survey to SLAC members with the three options under consideration to determine what are states doing today. All Governing Board members responded to the survey.

| Option | 1 | 2 | 3 |
|---------------|----------|----------|----------|
| | MA | AZ | AL |
| | NJ | IN | AR |
| | RI | MI | ME |
| | SD | TN | MN |
| | UT | VA | NE |

| | | | |
|--|----------|----------|-----------|
| | NC | WA | ND |
| | OK | WI | OH |
| | IA | NAOC | TX |
| | | KY | KS |
| | | | WV |
| | | | NV |
| | | | IL |
| | | | ID |
| | | | VT |
| | | | WY |
| | | | |
| | 8 | 9 | 15 |

Thirty-two out of 45 states/territories responded to the survey and 1 out of 4 local government agencies responded.

SLAC did not get response from the following SLAC members: California, Connecticut, District of Columbia, Florida, Georgia, Maryland, Mississippi, Missouri, New Mexico, New York, Pennsylvania, Puerto Rico, South Carolina, Government Finance Officers Association, National League of Cities, and U.S. Conference of Mayors.

Recommendations

The sales price definition provides in part:

“**Sales price**” shall not include:

- A. Discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;

All states participating in the discussion indicated a reduction in the sales price of tangible personal property or services sold, leased or rented to an employee that is 1) not reimbursed by a third party; 2) made available to all employees; 3) not awarded or earned in return for achieving goals or job performance levels; and 4) not convertible into a cash award is a discount allowed by a seller (employer) and taken by a purchaser (employee) on a sale that is not included in “sales price.”

SLAC recommends the following language be included in a sales price definition rule:

Discounts not included in “sales price” include but is not limited to reductions in the total amount of consideration for which personal property or services are sold, leased or rented to an employee that is made available to all employees and is not awarded or earned in return for achieving goals or job performance levels or cannot be converted to a cash award.

In addition, SLAC recommends the following permissive language be added at the end of the sales price definition in the Streamlined Sales and Use Tax Agreement, Appendix C Part 1.

States may also exclude from “sales price” reductions in the amount of consideration on a sale, lease or rental to an employee that are either awarded or earned in return for achieving goals or job performance levels, or an award that is convertible to cash payments.