

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 12-30**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee sales and use tax to a customer loyalty incentive program.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER] is a holding company with the following operating subsidiaries in Tennessee: [REDACTED] (collectively, the "Taxpayer"). These operating subsidiaries are licensed to, and do provide, wireless telecommunications services in Tennessee (including voice service, data service, and wireless Internet access) under the trade name [TRADE NAME]. [TAXPAYER] is a [NON-TENNESSEE] holding company that is not licensed to, and does not provide, wireless telecommunications services.

The Taxpayer has recently redesigned its wireless telecommunications service plans, introducing them under the name “[PLANS].” The [PLANS] transform the relationship between the Taxpayer and its customers from the historic contract-based relationship to a customer loyalty-based relationship. The Taxpayer introduced a points-based loyalty awards program that is included with its [PLANS]. Over time, subscribers to these plans accrue points, which can be exchanged for the following: a discounted new phone; discounts on phone accessories; certain digital goods and services; an additional line; forgiveness of certain overage charges; or an acceleration of the right to buy a discounted phone. In connection with the [PLANS], the Taxpayer has also introduced a program under which customers will receive a discount on their wireless service bills if they sign up for a program to receive paperless bills and automatically pay their bills online.

In the past, the Taxpayer has offered its customers one or two-year contracts, in exchange for which the customer was offered a discount on the purchase price of a new phone. Each month, a customer paid a set amount, which entitled the customer to a certain number of (or in some cases, unlimited) voice minutes, text messages, and/or data service. If a customer consumed voice or data in excess of the contract limit, there was an extra charge (an “Overage”). When a customer’s contract period expired, the customer had the opportunity to enter into a new one or two-year contract, and had another opportunity to purchase a new phone at a discount at that time. If a customer canceled service before the expiration of the contract, the customer was charged an early termination fee.

Beginning [DATE], the Taxpayer unveiled the [PLANS] referenced above. At the core of the [PLANS] is a new points-based customer loyalty program (the “Loyalty Program”). When a new customer signs up for a [PLAN], he or she is automatically enrolled in the Loyalty Program at the same time, for no additional charge. Under the terms of the [PLAN], the new customer signs an initial two-year contract and has the opportunity to buy a phone for a significant discount, sometimes for as little as one cent, at the time of enrollment. No further contract is required after the first two-year contract commitment is completed.

The Taxpayer charges a Wireless Monthly Fee, which now includes a set number of (or in some cases, unlimited) voice minutes and/or text and picture messages a customer is entitled to use for the month, and, in certain plans, data access. Plans with data access include differing preset numbers of gigabytes of data, with preset charges for excess data determined under the plan. A portion of the data service comprises Internet access. A customer can move between different [PLANS] for the duration of the contract. At the end of the initial [REDACTED] contract, the customer becomes a month-to-month subscriber, and can cancel at any time without penalty.

Under the Loyalty Program, the customer has the right to purchase a new phone at a significant discount (in some cases, for one cent) every [NUMBER OF] months, as long as he or she remains a [PLAN] subscriber. Unlike the Taxpayer’s former practice, a customer enrolled in the Loyalty Program is not required to sign a new [REDACTED] contract to receive this new discounted phone. Rather, every [NUMBER OF] months, a customer in good standing is entitled to a new discounted phone, without any further obligation to subscribe.

Other benefits of the Loyalty Program are provided through the accrual and redemption of Loyalty Program points (“Loyalty Points”). A customer earns Loyalty Points as follows: every

six months, based on the length of time the customer has been enrolled in the Loyalty Program; each month, based on the [PLAN] the customer is enrolled in; for each additional line added in certain family or business plans; for completing member profiles and online surveys; for backing up contact and phone book information with the Taxpayer; and for referring other customers. Also, an existing customer who signs up for a [PLAN] will receive a one-time award of “loyalty bonus” points (although due to inadvertent programming errors, some new customers also received these points).

Every month, a customer’s bill shows the Wireless Monthly Fee due, which is not allocated between voice service, text messages, data or points; rather, there is simply one lump-sum charge for the entire contract. A customer’s accrued Loyalty Points can be viewed only on the Taxpayer’s website, and are not shown on the bill. Loyalty Points cannot be purchased with or redeemed for cash under any circumstances. Loyalty Points can be redeemed only while the customer’s account is active and in good standing.

Once accrued, a customer can exchange Loyalty Points for the following: a discount on a new phone; a discount on phone accessories (*e.g.*, cases, extra batteries, covers, etc.);¹ free ringtones and ringback services; the addition of a line to an existing multi-line plan (*i.e.*, a family or business plan) for the first month, at no additional cost (an “Additional Line”); forgiveness of the charges stemming from data or voice consumption in excess of the contract limit for a given month (“Overage Forgiveness”); or an acceleration of the right to buy a discounted phone before the default [TIME] period expires (“Phone Acceleration”).² Loyalty Points cannot discount the price of phones or tangible accessories to less than one cent. The only means by which the Taxpayer permits a customer to obtain Phone Acceleration is by redeeming Loyalty Points; the Taxpayer does not charge for or otherwise permit a customer to accelerate a discounted phone purchase.

A customer can redeem Loyalty Points in several ways. First, a customer can log in through a website to select among a limited set of rewards. Alternatively, a customer can go to a Taxpayer-owned store, a Taxpayer store owned by an independent agent, or call the Taxpayer to redeem points for the full range of rewards. In each case, the customer is required to pay at least one cent when redeeming points for phones or accessories.

The Taxpayer allocates a small portion of the Wireless Monthly Fee each month to what it has determined relates to nontaxable Internet access service.

The Taxpayer encourages its customers to receive and pay their bills online. To this end, the Taxpayer has introduced a program under which a customer receives a [PERCENTAGE] discount (for payment with a debit or credit card), or a [PERCENTAGE] discount (for payment

¹ Accessories are shipped to the customer via mail from the Taxpayer’s third-party fulfillment center [OUTSIDE OF TENNESSEE], even when points are redeemed at a Taxpayer owned store or an independently owned store.

² For example, a customer who received a new phone [NUMBER OF] months ago would have to wait [NUMBER] more months for the right to buy a new phone at a discount. If the customer wanted a new phone that the Taxpayer just began offering without paying the full price, the customer would have the option of exchanging a certain number of Loyalty Points for the right to buy the new phone at a discount immediately, without waiting the remaining [NUMBER OF] months. The customer would then receive whatever discount the Taxpayer was offering on the new phone at that time.

by direct debit from the customer's checking account) on the price of his or her Wireless Monthly Fee each month if the customer sets up automatic online bill payment with paperless billing.

RULINGS

1. For Tennessee sales and use tax purposes, with respect to the Wireless Monthly Fee, is the sales price decreased by the imputed value of any Loyalty Points issued to the customer?

Ruling: No.

2. For Tennessee sales and use tax purposes, with respect to the Wireless Monthly Fee, is the sales price decreased by the discount for automatically paying online and accepting paperless billing?

Ruling: Yes.

3. For Tennessee sales and use tax purposes, when Loyalty Points are exchanged for discounted tangible personal property, digital goods, taxable services, or the purchase of a discounted phone at an earlier date as a result of Phone Acceleration, does the sales price of the item equal the net amount of cash paid by the customer for the item or service?

Ruling: Yes, the sales price equals the net amount of cash or other consideration paid by the customer.

4. When Loyalty Points are exchanged for discounted tangible personal property, is the Tennessee use tax imposed on the Taxpayer with respect to such tangible personal property?

Ruling: No, but the Taxpayer will be responsible for paying the sales tax if it fails to collect and remit the same from its customer.

5. Is the Tennessee sales and use tax imposed on the redemption of Loyalty Points for nontaxable goods or services?

Ruling: No, unless the nontaxable goods or services are bundled with taxable goods or services for a single charge.

ANALYSIS

Retail sales in Tennessee of tangible personal property and certain enumerated items and services are subject to the sales and use tax under the Retailers' Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 to -907 (2011), unless an exemption from taxation applies.

TENN. CODE ANN. § 67-6-102(80)(A) (2011) defines the term "sale" in pertinent part to mean "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or

otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration.” *Accord Nashville Clubhouse, Inc. v. Johnson*, 27 S.W.3d 542, 544 (Tenn. Ct. App. 2000) (“[T]here are three elements necessary to constitute a taxable sale: (1) the transfer of title or possession or both, (2) of tangible personal property, and (3) for a consideration.”).

Services are also taxable under the Retailers’ Sales Tax Act. TENN. CODE ANN. § 67-6-201(a)(3) (2011); *see also* TENN. CODE ANN. § 67-6-102(80)(C). But the sales tax does not apply to all services; rather, it only applies to retail sales of those services specifically enumerated by the statute. *See Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at *3 (Tenn. Ct. App. Aug. 12, 1994). One of the enumerated services taxable under the Retailers’ Sales Tax Act is “[t]he furnishing, for a consideration, of intrastate, interstate or international telecommunications services.” TENN. CODE ANN. § 67-6-205(c)(3) (2011). The term “telecommunications service” is defined under TENN. CODE ANN. § 67-6-102(92)(A) as the “electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.”

1. Wireless Monthly Fee and Loyalty Points

With respect to the Wireless Monthly Fee, the sales price is not decreased by the imputed value of any Loyalty Points that are issued to the customer. The sales price is only decreased when Loyalty Points are redeemed.³

The provision of wireless telecommunications service in Tennessee is clearly a taxable service under the Retailers’ Sales Tax Act. *See* TENN. CODE ANN. § 67-6-205(c)(3).

The “sales price” of a service is “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.” TENN. CODE ANN. § 67-6-102(81)(A). Consideration, for purposes of determining if there is a sale, is “either a benefit to the promisor or a detriment to or obligation on the promisee.” *Nashville Clubhouse, Inc. v. Johnson*, 27 S.W.3d at 545 (citing *Trailer Conditioners, Inc. v. Huddleston*, 897 S.W.2d 728, 731 (Tenn. Ct. App. 1995)).

Discounts, however, are excluded from the definition of sales price. *See* TENN. CODE ANN. § 67-6-102(81)(B). To further clarify this principle, TENN. COMP. R. & REGS. 1320-5-1-.12 (2008) provides in pertinent part that “[t]he selling price of . . . [a] taxable service does not include the amount of bona fide cash discounts actually taken by the buyer.” *See also* 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶ 17.05, at 17-17 (3d ed. 2000 & Supp. 2012) [hereinafter “HELLERSTEIN”] (“A cash discount that the seller gives at the time of the sale and that is not dependent on time of payment, volume of purchases, or similar factors almost always is excluded from the sales tax base on the premise that the discount is not part of the sales price.”); BLACK’S LAW DICTIONARY 532 (9th ed. 2009) (defining “discount” as “[a] reduction from the full amount or value or something, esp. a price”). TENN. CODE ANN. § 67-6-

³ The effect of redeeming Loyalty Points for discounts on merchandise and services is discussed in Question #3.

102(81)(B)(i) further provides that a discount includes “coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale.”

The Taxpayer here provides its customers with Loyalty Points every six months, based on the length of time the customer has been enrolled in the Loyalty Program; each month, based on the [PLAN] the customer is enrolled in; for each additional line added in certain family or business plans; for completing member profiles and online surveys; for backing up contact and phone book information with the Taxpayer; and for referring other customers, in addition to a one-time bonus award for signing up for a [PLAN]. These Loyalty Points cannot be purchased with or redeemed for cash under any circumstances, and have no value if the customer cancels service with the Taxpayer. Finally, the Taxpayer is not reimbursed by any third party for the Loyalty Points.

Under these circumstances, the Loyalty Points are properly considered as in-store coupons. *See generally* 2 HELLERSTEIN, ¶¶ 17.05-.06. Coupons are “equivalent to a cash discount given at the time of sale,” 2 HELLERSTEIN, ¶ 17.06[1], at 17-19, and have no intrinsic value otherwise when they have no cash value. Consequently, the issuance of Loyalty Points has no bearing on the sales price of the telecommunications service (*i.e.*, the Wireless Monthly Fee).

2. Wireless Monthly Fee and Paperless Billing and Online Payment Discounts

With respect to the Wireless Monthly Fee, the sales price is decreased by the discount provided for enrolling in paperless billing and making online payments.

As explained above, the “sales price” of a service equals the total consideration, less any discounts allowed by the seller and taken by the purchaser on a sale which are not reimbursed by a third party. *See* TENN. CODE ANN. § 67-6-102(81)(A)-(C).

In this case, the Taxpayer reduces the Wireless Monthly Fee by a percentage amount whenever its customers pay via debit or credit card or enroll in automatic online bill payment with paperless billing. This decrease is a reduction from the regular price, which is not reimbursed by a third party,⁴ and is thus a bona fide cash discount. The sales price of the Wireless Monthly Fee, for purposes of Tennessee sales and use tax, is therefore the net amount actually paid.

3. Redemption of Loyalty Points

When Loyalty Points are exchanged for discounted tangible personal property, digital goods, or taxable services, the sales price equals the net amount of cash and/or other consideration paid for the item or service. Similarly, when Loyalty Points are exchanged for Phone Acceleration, the sales price equals the net amount of cash and/or other consideration paid for the phone.

As explained in the response to Question #1, the sales price of tangible personal property or of a taxable service equals the total consideration, less any discounts allowed by the seller and taken by the purchaser on a sale which are not reimbursed by a third party. *See* TENN. CODE ANN. § 67-6-102(81).

⁴ *See* TENN. CODE ANN. § 67-6-102(81)(B)(i).

Whenever the Taxpayer's customers redeem the Loyalty Points for a lower cash price on services or merchandise, the Loyalty Points act as a discount. Specifically, the Loyalty Points function as an in-store coupon that is not reimbursed by a third party. This discount is excluded from the sales price under TENN. CODE ANN. § 67-6-102(81)(B)(i), and the sales price equals the net amount of cash or other consideration paid by the customer.⁵

The same analysis applies to the redemption of Loyalty Points in exchange for the acceleration of the right to buy a discounted phone before the default [NUMBER]-month period expires. Upon redeeming Loyalty Points for Phone Acceleration, the Taxpayer's customers immediately purchase a discounted phone. As is the case with the other Loyalty Point redemptions previously mentioned, the sales price of the phone will equal the total consideration, less any discounts, whenever the Taxpayer's customer redeems Loyalty Points for Phone Acceleration. *See* TENN. CODE ANN. § 67-6-102(81).

4. Use Tax Obligation

When Loyalty Points are exchanged for discounted tangible personal property, the Tennessee use tax is not imposed on the Taxpayer with respect to such tangible personal property. The Taxpayer will, however, be responsible for paying the sales tax if it fails to collect and remit the appropriate amount of sales tax from its customer.

As stated in the response to Question #3, the sales price is established as the total amount of consideration, less any discounts. *See* TENN. CODE ANN. § 67-6-102(81). The Taxpayer's discounted sales of tangible personal property would not generally implicate the use tax.

In one circumstance, however, the Taxpayer would be responsible for paying the sales tax on its sale of tangible personal property. Under the Retailers' Sales Tax Act, "[t]he legal incidence of the sales tax is upon the seller, not upon the consumer." *Long Equip. Co. v. Keeton*, 736 S.W.2d 611, 613 (Tenn. Ct. App. 1987); *see also* TENN. CODE ANN. §§ 67-6-501 to -502 (2011). The retailer is permitted to collect the sales tax from the consumer "insofar as it can be done," TENN. CODE ANN. § 67-6-502, but the retailer remains ultimately responsible for paying the tax.

In the event that the Taxpayer fails to collect and remit the appropriate amount of sales tax as determined in accordance with the response to Question #3 from its customer, the Taxpayer would then be responsible for paying the appropriate amount of sales tax pursuant to TENN. CODE ANN. § 67-6-501.

5. Loyalty Points and Nontaxable Goods or Services

The Tennessee sales and use tax is generally not imposed on the redemption of Loyalty Points for nontaxable goods or services, unless the nontaxable goods or services are bundled with taxable goods or services.

⁵ Note that if the Taxpayer simply provides a phone to customers that subscribe to its wireless telecommunications services, the Taxpayer will only collect sales tax on the sales price of the wireless telecommunications services, since such price also includes the phone provided with the wireless service.

A nontaxable service or item may be subject to taxation when charges for the nontaxable service or item are included in the sales price of a taxable good or service. Specifically, TENN. CODE ANN. § 67-6-102(81)(A) provides that the sales price of a good or service equals the “total amount of consideration . . . for which personal property or services are sold,” with no deduction for the seller’s costs or charges by the seller for services necessary to complete the sale. Thus, if taxable goods or services and nontaxable goods or services are sold together for a single charge, the entire charge is generally subject to taxation. *See Tomkats Catering, Inc. v. Johnson*, No. M2000-03107-COA-R3-CV, 2001 WL 1090516, at *2 (Tenn. Ct. App. Sept. 19, 2001).

Consequently, if the Taxpayer’s customer redeems Loyalty Points for a nontaxable good or service standing alone, the transaction is not subject to sales tax. But if the Taxpayer’s customer redeems Loyalty Points for a nontaxable good or service in conjunction with taxable goods or services for a single charge, the entire amount paid, net of any discounts in accordance with the reasoning set forth in Question #1, will be the “sales price” for purposes of determining the sales tax due.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

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