

Taxing Groupon-Type Coupons: New York Tax Department Guidance

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Have you hopped on the social media bandwagon yet and started purchasing online discounted coupons for such varied things as a zip-line adventure, a dental exam and cleaning, or a meal at your local Italian eatery? In this column, we try to stay current, and we try to keep you current on what's going on in the world of New York taxes. If you haven't been paying attention, social buying and daily deal coupons are flooding the Internet and e-mail inboxes, and have become a big business. Coupons, it seems, have taken on a degree of cache.

For example, Groupon, which launched in November 2008, offers daily discounts for local businesses. It's been considered the fastest growing Internet company in history, operating in 675 cities across the globe with 54 million users.¹ LivingSocial, a top competitor, claims 45 million users and boasts 589 daily deal markets.² These companies, and many other similar competitors, promise to save you and me money while generating new customers for participating merchants by selling prepaid discounted vouchers, or coupons, for local goods and services that we didn't even know we wanted to buy.

Although both the business model and the impressive explosion of these companies are worth reading about, here we want to draw your attention to the most "interesting" aspect to our loyal, albeit somewhat geeky, readers: how these offerings fit into the world of taxes.

If you were to dig through Groupon's "frequently asked questions" on its website, you'd find the following on taxation:

[Question] How much sales and use tax should be charged when a Groupon is redeemed?

[Answer] States and cities often have complicated sales and use tax laws that may be confusing to you. Factors such as where you live, where you redeem your Groupon and for what goods or services you redeem it may affect how the Groupon is treated for purposes of taxation. It is every merchant's responsibility to collect and remit tax as required by applicable law.³

In other words, they don't have a clue!

The New York Department of Taxation and Finance has recently issued guidance that spells out the sales and use tax treatment of these types of daily deal transactions.⁴ As a preliminary matter, it is worth noting that the department's guidance took the form of a technical memorandum. A technical memorandum is an informational statement of existing department policies or of changes to the law, regulations, or policies. A technical memorandum is initiated by the department to advise and inform taxpayers, tax practitioners, its own personnel, and members of the general public of the department's position on a particular issue. Technical memoranda are not, however, regulations. And as the regulations themselves make clear, technical memoranda "in themselves have no legal effect but are merely

¹David Pogue, "Psyched to Buy, in Groups," *The New York Times* (Feb. 9, 2011).

²See <http://livingsocial.com/bythenumbers>.

³See <http://www.groupon.com/faq>.

⁴TSB-M-11(16)S (Sept. 19, 2011). (For the memo, see *Doc 2011-19844* or *2011 STT 184-18*.)

explanatory.⁵ That said, they are effectively the rules of the road, so let's take a look.

A Typical Transaction

While each daily deal company may offer a unique twist on its offerings, the typical transaction, so that we have a baseline understanding, works as follows: The online company, which the department calls a deal site, solicits customers (you and me) to purchase a voucher for use at a participating local merchant. The deal site collects the purchase price of the voucher from the customer. The customer receives the voucher by e-mail and can then redeem it for goods or services at the merchant's place of business. A typical example would be a voucher for \$100 worth of product sold by the deal site for \$50. The deal site will keep a portion of that \$50 as its revenue and share the balance with the merchant. The deal site may consider itself to be providing an advertising service for the merchant or acting as the merchant's collection agent.

Sales Tax Treatment of the Sale of the Voucher

The department's technical memorandum clearly explains that there is no sales tax due on the purchase of a voucher by the customer from the deal site. On this issue, there was some confusion in the industry, resulting from a 2007 advisory opinion that seemed at least to suggest that there was a distinction between the taxability of a gift certificate for unspecified goods or services and the taxability of the sale of a certificate or coupon for specific goods.⁶ But the technical memorandum makes clear that no tax is due, ever, on the sale of a certificate. That makes sense, because the sales tax is imposed only on receipts derived from the sale of tangible personal property and of specific, enumerated services.⁷ An electronic coupon is not tangible personal property, nor is advertising, or whatever this activity might be, an enumerated service.

The technical memorandum makes clear that no tax is due, ever, on the sale of a certificate.

Rather, sales tax is due when the voucher is redeemed, provided it is redeemed for a taxable good or service. So if you find that you are being charged New York's sales tax when you purchase the coupon, something may be wrong.

⁵20 N.Y.C.R.R. section 2375.6(c).

⁶TSB-A-07(21)S.

⁷Tax Law section 1105(a),(c).

Sales Tax Treatment of Redemption of the Voucher

Now let's examine the other leg of the transaction. Sales tax will be due when the voucher is redeemed, provided the voucher is redeemed for a taxable product or service. It may not be. Remember that e-mail you received pitching a dental exam, dental cleaning, and X-rays, a \$350 value, for \$79?⁸ Medical and dental services are not an enumerated service in New York, so no sales tax would be due at checkout.

However, it's been a long week and you may decide that instead of a dental exam, you'd prefer a 60-minute massage, a \$140 value, for \$49.⁹ Personal care services, such as massage services, are not subject to sales tax by New York State, *but* they are subject to sales tax by New York City (at least until 2014).¹⁰ Accordingly, if a customer were to redeem this voucher within New York City, sales tax would be due and should be collected by the merchant.

Once you've determined whether the sales tax applies to the underlying product or service, you need to consider the amount of the transaction that will be subject to tax. That, in turn, depends on the type of voucher that the customer has purchased: Is the voucher for a specific product or service, or is it for a specifically stated face value? There are significant differences depending on which type of voucher you are dealing with.

Voucher for a Specific Product or Service

A voucher for a specific product or service is a voucher without a specific stated value that may be redeemed only for a specified product or service. An example would be a voucher for \$20 that entitles the customer to an oil change service. That voucher still qualifies if the regular selling price, say \$40, of that product or service is stated on the voucher. With this type of voucher, the amount subject to sales tax is the total price that the customer paid for the voucher — \$20 in our example. This, of course, creates the potentially uncomfortable situation in which the vendor has to say "that'll be \$2, please" for the customer's "free" oil change.

What if that same \$20 voucher entitled the customer to two oil change services instead of one? In that case, the technical memorandum tells us, the amount subject to sales tax on each redemption would be determined, quite reasonably, by dividing the purchase price, \$20, by the number of times that the voucher may be used, two times. So if our

⁸As this article was being written, this offer was available at www.livingsocial.com for a dentist in New York City.

⁹As this article was being written, this offer was available at www.groupon.com for a massage therapist also in New York City.

¹⁰NYC Administrative Code section 11-2002.

customer takes her voucher to get her car's oil changed, \$10 would be subject to sales tax on the first service and \$10 would be subject to sales tax on the second service. That means the vendor has to go through *two* uncomfortable conversations with said customer.

Some vouchers for a specified product or service may entitle the customer to purchase a combination of products and services. In those cases, if the product is taxable, but the service is not subject to tax, or vice versa, because the items are packaged together and cannot, under the voucher, be broken apart, the entire transaction would be subject to tax. Similarly, if taxable items are sold together with exempt items in a single transaction, everything will be subject to tax. This is known as the "cheeseboard rule."¹¹ When taxable and exempt or nontaxable items are sold together as a single unit, the entire transaction is treated as taxable.

Merchants need to understand these rules so they understand what and how much to collect. Going back to the oil change service example discussed above, if a merchant collected sales tax on that first oil change but failed to collect sales tax from the customer on the second oil change, we can safely assume that an auditor would treat that second service as an unreported sale of sorts, whereby the merchant, after the fact, would be required to remit the uncollected tax. Good luck going back to that customer and attempting to get reimbursed.

The technical memorandum walks through several useful examples. Here's one of the better ones:

Example 4. Ms. K purchases a voucher for \$6 which is redeemable for admission to a movie theater to view a movie and for a box of popcorn and a fountain soda at the movie theater's snack bar. Since the voucher that Ms. K purchased is redeemable for a combination of taxable and non-taxable products (*i.e.*, the box of popcorn and fountain soda are taxable items but the admission charge to the movie theater is non-taxable), the total amount paid for the voucher is subject to sales tax. Assuming a state and local combined sales tax rate of 7 percent, the movie theater would be required to collect 42 cents of sales tax (7 percent x \$6) from Ms. K when she redeems the voucher.¹²

I hope Ms. K. brought some loose change along with that coupon.

Voucher for a Specifically Stated Face Value

When a coupon or voucher is for a specifically stated face value, the value of the voucher is applied

toward the purchase price when redeemed by the customer. An example would be a voucher that sells for \$15 and entitles the customer to \$50 worth of products at a market.

The technical memorandum tells us that these vouchers are treated in the same manner as a gift card. In other words, the voucher is treated as cash, up to its stated face value, that a customer can apply toward the purchase price. This rule seems easy enough to apply. But there are a few points to understand.

First, for a voucher with a stated face value, as opposed to a voucher for a specific product or service, the cheeseboard rule mentioned above won't necessarily come into play. For example, a customer might purchase a voucher for \$15 that entitles her to purchase \$65 worth of products at a market. Imagine that this customer purchases a total of \$80 worth of products, consisting of \$43 of taxable products and \$37 of nontaxable products. If the customer uses the voucher to pay \$65 (its stated face value) of the bill, the amount subject to tax is \$43, not \$65 or \$80. That is because the taxable and nontaxable items can be purchased separately, the market can separately state the charge for each item on the invoice, and here, there is no concern that the charges may have been manipulated and unreasonably allocated between taxable and nontaxable items.¹³

The situation above raises yet another issue: What if the purchase price is more than the stated face value of the voucher, as it is above? What if it is less?

If the voucher is redeemed for taxable products or services with a value equal to or more than its face value, sales tax will be due on the full purchase price when the voucher is redeemed. If, however, the voucher is redeemed for taxable products or services with a value less than its face value, according to the technical memorandum, the merchant may select two options in collecting the sales tax due.

At the merchant's election, it may collect the sales tax due in cash from the customer, and the voucher would simply retain some residual value. Alternatively, the merchant may allow the customer to use the voucher's remaining balance to pay the sales tax. The technical memorandum is quick to point out that if a merchant opts to allow a customer to use a voucher to pay the sales tax, that merchant must remember to remit the full amount of the sales tax due even though no sales tax cash has in fact been collected from the customer. Merchants will need to account for this and maintain those records.

¹¹20 N.Y.C.R.R. section 527.1(b) ("A vendor sells a package containing assorted cheeses, a cheese board and a knife for \$15. He is required to collect tax on \$15.")

¹²TSB-M-11(16)S (Sept. 19, 2011).

¹³See New York Sales Tax Bulletin No. TB-ST-860 (June 16, 2011) (addressing sales tax treatment when taxable and non-taxable items are sold together).

The technical memorandum again walks through several useful examples. Here's one:

Example 7. Mr. Jones purchases a voucher for \$50 which is redeemable for \$100 worth of food and drink at a local restaurant. Mr. Jones goes to the restaurant and purchases meals and drinks subject to sales tax that has a total price of \$90. The amount subject to sales tax is \$90. Assuming a state and local combined sales tax rate of 8%, the sales tax due from Mr. Jones through the redemption of the voucher would be \$7.20 (8% x \$90). Therefore, the total amount owed by Mr. Jones for the food, drink and sales tax is \$97.20. The restaurant allows Mr. Jones to use the voucher to pay the entire \$97.20. Even though the restaurant did not collect any money from Mr. Jones, the restaurant must include the \$7.20 of sales tax that Mr. Jones paid through the redemption of the voucher, when it files its sales tax return for the period during which Mr. Jones redeemed his voucher.¹⁴

Let us hope that Mr. Jones uses that coupon for nonalcoholic drinks, otherwise, it'll be tough for him to understand how sales tax is being applied. Heck, it's hard enough to understand sober!

Conclusion

This article aspires to be more than an echo of your mother's sage advice to cut coupons.¹⁵ As you

¹⁴TSB-M-11(16)S (Sept. 19, 2011).

¹⁵If you are a retailer or are otherwise interested in sales tax issues pertaining to coupons, you may also wish to refer to

can see, there are sizable compliance issues that merchants must be aware of when transacting business through prepaid discount vouchers.

Merchants have to determine first whether the product or service being purchased is taxable. If some items are taxable and some are not, does the cheeseboard rule apply? Is the voucher for a specific product or service or is it for a stated face value? If the voucher is for a specific product or service and that product or service may be redeemed more than once, a merchant must remember to collect the appropriate amount of tax from the customer each time the voucher is redeemed. If a stated face value voucher is redeemed for a purchase price that is less than its stated face value, a merchant should allow its customers to use the remaining value of the voucher to pay the tax only if it has systems in place to ensure that it remits the full amount of the tax due.

The tremendous growth of this business model ensures that these and many other issues will crop up with increased frequency. ☆

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guidance issued by the department in 2010 discussing the difference between manufacturers' coupons and store-issued coupons. See New York State Tax Bulletin No. TB-ST-140 (Mar. 26, 2010).

(Footnote continued in next column.)