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Client Alert: Loyalty Program Discounts Clarified for Retail Vendors in Ohio

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Ohio's 2012-2013 budget bill, Am. Sub. H.B. 153, became effective at midnight June 30, 2011. It is a monster bill with nearly 4,500 pages of new and amended statutes. Among its many provisions is legislation that clarifies application of sales tax to transactions involving discounts provided by retail vendors under loyalty or award programs.

A simple example best illustrates the point. Say you go to your favorite store and are told that, if you purchase \$100 of goods, you will receive a \$20 gift card for use on your next visit. You make a \$100 purchase, on which the store collects the appropriate sales tax. You receive your \$20 gift card. On your next visit, you purchase a \$100 item. You apply the \$20 gift card and pay the difference of \$80 in cash. The Ohio Department of Taxation has recently begun to take the audit position that the retailer should collect sales tax on the full \$100. In other words, the recent audit position is that the \$20 gift card was a "purchased" discount (much like a gift certificate, which is not treated like a discount to price under Ohio law) and was part of the consideration paid on the taxable "price."

Over the past ten years, vendor loyalty and other award programs have grown widespread, varied and valuable. The dollars at stake are enormous, as are the compliance hurdles and tax risks for wrong decisions. Marketing departments move at light speed to roll out new or expanded programs, leaving tax departments to sweep up the remains using antiquated systems and statutes that are hopelessly outdated. On top of the compliance complexity in any one state, retail vendors often face compliance hurdles on a multi-state basis. States often reach inconsistent positions on the same facts. As state revenues have dropped during the recession, audit policies have become more aggressive, making this an area of acute concern.

For its part, Ohio has attempted to provide some clarity and sanity to the situation. Am. Sub. H.B. 153 added a new section to the definition of "price." R.C. 5739.01(H)(c)(v). The new provision makes it clear that Ohio sales tax does not apply to the portion of the price paid for an item or service with a gift card that is provided as part of a loyalty or award

program. This statutory exception does not apply to all gift cards and gift certificates. Rather, it applies only where the following requirements have been met: 1) the gift card cannot be one that was sold by the vendor or purchased by the consumer; 2) the card must be distributed pursuant to the vendor's award, loyalty or promotional program; and, 3) the vendor cannot receive any reimbursement or compensation from a third party to cover any of the value of the card (such as where manufacturers reimburse stores for the value of coupons the manufacturer provides to shoppers). Importantly, the legislation provides that a customer's purchases at the store will not be considered compensation to the store for the purchase of the gift card. This ensures that the redeemed value of the gift card will not be subject to sales tax because under the circumstances it is neither sold by the vendor nor purchased by the consumer.

Finally, the legislation defines a "gift card" as any document, card, certificate or other record, whether tangible or intangible, that may be redeemed for a dollar value when a purchase is made. R.C. 5739.01 (PPP). This definition is broad enough to encompass "digital gift cards," such as those provided electronically by retail vendors.

Although strong legal arguments could be made under Ohio law prior to Am. Sub. H.B. 153 that the same result should occur, this new legislation provides vendors piece of mind about the sales tax consequences with regard to gift cards provided through vendor loyalty programs. It should also ensure consistent tax treatment within Ohio for all vendors who offer their customers this type of incentive to shop at their stores or use their services. The Vorys law firm will continue to monitor this subject area in Ohio and other states for developments.

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