INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-108577-04/CC:TEGE:EOEG:ET2

Taxpayers' Name:

Taxpayers' Address:

Taxpayers' Identification No

Years Involved:
Date of Conference:

LEDGEND:

City A =

State B =

Year One =

Year Two =

ISSUE:

Whether an employer-provided holiday gift coupon with a face value of thirty-five dollars that is redeemable at several local grocery stores is excluded from gross income and wages as a de minimis fringe benefit under Internal Revenue Code (Code) § 132(a)(4).

CONCLUSION:

An employer-provided holiday gift coupon with a face value of thirty-five dollars that is redeemable at several local grocery stores is not excludable from gross income and wages as a de minimis fringe benefit under Code §132(a)(4).

FACTS:

The Taxpayer is recognized as a tax-exempt organization as described within Code § 501(c)(3). Prior to year one, the Taxpayer provided employees with a ham, turkey or gift basket as an annual holiday gift. Beginning in year one and continuing in year two, the Taxpayer provided employees with a gift coupon as an annual holiday gift instead of providing employees with a ham, turkey or gift basket. The gift coupons had a face value of thirty-five dollars. The Taxpayer intended that the gift coupons would be approximately equal in value to the annual holiday gifts provided prior to year one.

The Taxpayer stopped providing a ham, turkey or gift basket and began providing a gift coupon because some employees with certain religious convictions and some employees with certain dietary limitations, such as vegetarians and people with health-related limitations, requested a gift coupon. The gift coupon provides employees with more choices and greater convenience. Additionally, the Taxpayer implemented the gift coupon program in order to reduce the costs previously incurred in obtaining and delivering holiday gifts to its employees (i.e., involvement of full-time employees and costs for transportation, etc.) and to eliminate any potential Taxpayer liability resulting from the provision of perishable food products to its employees.

The gift coupon provided in year one has the Taxpayer's name and address printed on the front. The thirty-five dollar face value and the words "gift coupon" are prominently displayed. The coupon lists food stores where the coupon is redeemable and provides the following restrictions: (1) the coupon is good towards the purchase of thirty-five dollars for any grocery product excluding tobacco, alcohol or pharmacy goods; (2) the listed grocery store may reserve the right not to accept the coupon; (3) the coupon can only be used once and any unused portion is forfeited; (4) the coupon is redeemable between November 15th and January 31st of the following year. The coupon is shaped like a bank check and includes the words "endorse here" next to a signature line in the bottom right corner. On the back side of the coupon, the employee's name and address

are printed along with a number which identifies the department in which the employee works.

The coupon provided in year one listed four food stores in the City A, State B area where the coupon was redeemable. The coupon provided in year two was identical to the coupon provided in year one, except that it listed 23 food stores where the coupon was redeemable in a larger tri-state area. Both the year one coupon and the year two coupon listed food stores that had more than one location where the coupon could be redeemed.

The Taxpayer did not withhold or pay any employment taxes[1] for any portion of the thirty-five dollar gift coupons provided to employees during tax years one and two.

LAW AND ANALYSIS:

Code § 61(a)(1) provides that gross income means any income from whatever source derived, including, but not limited to, compensation for services including fringe benefits.

Code § 3121(a) defines the term "wages" for FICA purposes as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exceptions. Code § 3401(a) provides that "wages" for income tax withholding purposes means all remuneration for services performed by an employee for his employer.

Code §§ 3121(a)(20) and 3401(a)(19) provide that for purposes of FICA and income tax withholding, respectively, the term "wages" shall not include any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under Code § 132.

Code § 132(a)(4) provides that gross income does not include any fringe benefit that qualifies as a de minimis fringe benefit. Code § 132(e)(1) defines a de minimis fringe benefit as any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable. Income Tax Regulation § 1.132-6(a) provides the same definition.

[1] Under Subtitle C of the Code, Chapters 21, 23 and 24, respectively, employment taxes consist of the Federal Insurance Contributions Act tax (FICA), the Federal Unemployment Tax Act tax (FUTA), and the Collection of Income Tax at Source on Wages (income tax withholding). However, service performed in the employ of an organization described in Code § 501(c)(3), like the Taxpayer, is not considered to be employment for FUTA tax purposes. See Code § 3306(c)(8).

Income Tax Regulation § 1.132-6(c) provides that, except for special rules that apply to occasional meal money, the provision of any cash fringe benefit is never excludable as a de minimis fringe benefit. Similarly, except for special rules that apply to occasional meal money and transit passes, a cash equivalent fringe benefit (such as a fringe benefit provided to an employee through the use of a gift certificate or charge or credit card) is generally not excludable under Code § 132(a) even if the same property or service acquired (if provided in kind) would be excludable as a de minimis fringe benefit. For example, the provision of cash to an employee for a theatre ticket that would itself be excludable as a de minimis fringe is not excludable as a de minimis fringe.

Income Tax Regulation § 1.132-6(e)(1) provides examples of de minimis fringe benefits that are excludable from an employee's gross income. These include occasional typing of personal letters by a company secretary; occasional personal use of an employer's copying machine; occasional cocktail parties, group meals, or picnics for employees and their guests; traditional birthday or holiday gifts of property (not cash) with a low fair market value; occasional theater or sporting event tickets; coffee, doughnuts, and soft drinks; local telephone calls; and flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., on account of illness, outstanding performance, or family crisis). In the legislative history of the Deficit Reduction Act of 1984 (DEFRA 1984), pursuant to which Code § 132 was enacted, Congress provided illustrations of benefits that are excludable as de minimis fringe benefits, such as "traditional gifts on holidays of tangible personal property having a low fair market value (e.g., a turkey given for the year-end holidays)." *See* Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 858-59 (1984) (hereinafter JCS-41-84).

Applying the statutory definition of a de minimis fringe benefit requires addressing three factors: value, frequency and administrative impracticability. *See* Code § 132(e)(1). Because cash and cash equivalent fringe benefits like gift certificates have a readily ascertainable value, they do not constitute de minimis fringe benefits because these items are not unreasonable or administratively impracticable to account for.

The Code § 132(e)(1) definition of de minimis fringe benefit is limited to property or services and does not include cash. *See also* Income Tax Regulation § 1.132-6(a). The specific example in the regulations describing holiday gifts is limited to property and does not include cash. *See* Income Tax Regulation § 1.132-6(e)(1). The holiday gift example that Congress provided in the DEFRA 1984 legislative history describes "tangible personal property." *See* JCS-41-84, p. 859. With specific exceptions not applicable in this case, Income Tax Regulation § 1.132-6(c) demonstrates that cash is not excludable as a de minimis fringe benefit even when the property or service acquired (if provided in kind) would be excludable as a de minimis fringe benefit.

It is not administratively impracticable to account for even a small amount of cash provided to an employee because the value of the amount provided is readily apparent and certain. Accordingly, unless a narrow and specific exception applies, such as the

special rules that apply to occasional meal money and transit passes, accounting for cash or cash equivalent fringe benefits such as gift certificates is never considered administratively impracticable under Code § 132. *See* Income Tax Regulation § 1.132-6(c).

After reviewing the facts in this case, it is our view that the employer-provided "gift coupon" operates in essentially the same way as a cash equivalent fringe benefit such as a gift certificate. As with a gift certificate, it is simply not administratively impracticable to account for the employer-provided gift coupons; they have a face value of thirty-five dollars. *See American Airlines, Inc. v. U.S.*, 40 Fed. Cl. 712, 725 (1998) (concluding that it was not administratively impracticable to value employer-provided American Express restaurant voucher with a fifty-dollar face value) *aff'd* in relevant part, 204 F.3d 1103 (Fed. Cir. 2000). Accordingly, we conclude that an employer-provided holiday gift coupon with a face value of thirty-five dollars that is redeemable at several local grocery stores is not excludable from gross income as a de minimis fringe benefit under Code §132(a)(4).

The Taxpayer acknowledges that the definition of a de minimis fringe benefit under Code § 132(e)(1) includes a determination of value, frequency and administrative impracticability. However, the Taxpayer contends that (1) Income Tax Regulation § 1.132-6(e)(1) provides that certain fringe benefits are excluded from an employee's gross income including "traditional holiday gifts of property (not cash) with a low fair market value;" (2) the employer-provided gift coupon in this case falls within this traditional gift of property "exclusion;" and (3) because the employer-provided gift coupon falls within this traditional gift of property "exclusion," the "Taxpayer is not required to follow the parameters of [Code] § 132(e)(1)."

We do not accept the Taxpayer's characterization of the relationship between Code § 132(e)(1) and Income Tax Regulation § 1.132-6(e)(1). We note that the heading for Income Tax Regulation § 1.132-6(e)(1) states that it describes "examples" of benefits excluded from income. Thus, the regulation itself does not provide an exclusion from gross income, it merely describes examples of fringe benefits that are potentially excludable assuming the statutory requirements pertaining to value, frequency and administrative impracticability are satisfied. The statute provides the basis for the exclusion, and the regulations implement the statute. The Taxpayer's characterization of the relationship between Code § 132(e)(1) and Income Tax Regulation § 1.132-6(e)(1) impermissibly expands the reach of the regulations beyond the scope of the statute.

We note that the legislative history makes clear that the statutory requirements regarding value, frequency and administrative impracticability must be satisfied even with respect to gifts on holidays of tangible personal property having a low fair market value. Specifically, the Joint Committee Report states that "…the frequency with which such benefits are offered may make the exclusion unavailable for that benefit, regardless of difficulties in accounting for the benefits. By way of illustration, the

exclusion is not available if traditional holiday gifts are provided to employees each month…" *See* JCS-41-84, p. 858.

Additionally, the Taxpayer contends that a 1961 district court case, *Hallmark Cards Inc., v. U.S.*, 200 F. Supp. 847 (W.D. Mo. 1961), provides the proper analysis in this case. The *Hallmark* court reviewed the Service's determination that employer-provided fifteen and twenty-five dollar "special gift certificates," which were redeemable in merchandise at any store that sold Hallmark's products were subject to employment taxes at the time the employees received them. In *Hallmark*, the court concluded that the "amounts provided for in the gift certificates were not intended as wages. They were intended to be gifts and gratuities, and in no wise to be considered as any part of the compensation to [Hallmark's'] employees." 200 F. Supp. at 850. Additionally, the court applied Revenue Ruling 59-58, 1959-1 C.B. 17, which provided that the value of an employer-provided holiday turkey, ham or other low value merchandise was not includable in gross income or wages, but further provided that the exclusion would not apply to employer-provided cash, gift certificates, and similar items of readily convertible cash value, regardless of amount involved. In concluding that the merchandise was excludable from gross income, Rev. Rul. 59-58 noted that "in many cases…such items constitute excludable gifts." In finding that the special gift certificates were not subject to employment taxes, the *Hallmark* court concluded that because the "special gift certificates" were not redeemable in cash, they were not readily convertible to cash. According to Taxpayer's argument, as in the *Hallmark* case, the employer-provided gift coupons in this case are not redeemable for cash and therefore should not be included in the employees' gross income or subject to employment taxes.

With regard to this argument raised by Taxpayer, we note that Rev. Rul. 59-58 applied employment tax regulations involving the use of an employer's "facilities or privileges." Specifically, Rev. Rul. 59-58 involves the application of Employment Tax Regulation § 31.3401(a)-1(b)(10), which provides for income tax withholding purposes:

> Facilities or privileges. Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as wages subject to withholding if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employee.

See also Employment Tax Regulation §§ 31.3121(a)-1(f) for FICA purposes and 31.3306(b)-1(f) for FUTA purposes.

The analysis in the *Hallmark* case and in Rev. Rul. 59-58 has been superseded by changes in the law. In this regard, we note that the conclusions in both of these authorities that the items provided by the employer to its employees were "gifts" preceded the enactment of Code section 102(c) pursuant to which amounts transferred

by or for an employer to, or for the benefit of, an employee are not excludable from the employee's gross income as gifts.[2] Moreover, both of these authorities preceded DEFRA 1984, which enacted a comprehensive scheme dealing with employer-provided fringe benefits, and thus largely superceded earlier-decided case law and earlier-issued Internal Revenue Service administrative guidance on employer-provided fringe benefits.

On July 18, 1984, Congress enacted § 531 of DEFRA 1984 amending Code § 61(a) to include "fringe benefits" in the definition of gross income and adding Code § 132 to exclude certain fringe benefits from gross income. DEFRA 1984 also provided the Treasury Department with the specific authority to promulgate any regulations necessary to carry out the purposes of Code § 132. Code § 132 substituted a statutory approach for the prior common law approach in determining whether employer-provided fringe benefits are excluded from gross income. The prior common law approach generally looked to whether the fringe benefit was compensatory or noncompensatory. Consequently, effective January 1, 1985, any fringe benefit is includable in the recipient's gross income unless the fringe benefit is excluded from gross income by a specific statutory provision.

Congress intended to create certainty by providing clear rules for the tax treatment of fringe benefits. Thus, DEFRA 1984 sets forth statutory provisions under which (1) certain fringe benefits provided by an employer are excluded from the recipient employee's gross income for Federal income tax purposes and from the wage base (and, if applicable, the benefit base) for purposes of income tax withholding, FICA, FUTA, and the Railroad Retirement Tax Act, and (2) any fringe benefit that does not qualify for exclusion under the bill and that is not excluded under another statutory fringe benefit provision of the Code is includable in gross income for income tax purposes, and in wages for employment tax purposes, at the excess of its fair market value over any amount paid by the employee for the benefit. The latter rule is confirmed by clarifying amendments to Code §§ 61(a), 3121(a), 3306(b), and 3401(a) and § 209 of the Social Security Act. *See* JCS-41-84, p. 842.

After the passage of DEFRA 1984, it is necessary to apply Code § 132(e) and the regulations thereunder when analyzing whether a low-value, employer-provided holiday gift is excludable from gross income. The statutory scheme designed by Congress to analyze de minimis fringe benefits specially addresses low-value, employer-provided holiday gifts. *See* JCS-41-84, p. 858-59 (providing for de minimis fringe benefit treatment of "gifts on holidays of tangible personal property having a low fair market value (e.g., a turkey given for the year end holidays")). Accordingly, the appropriate body of law to apply in this case is Code §132(e) and its regulations and not the "facilities and privileges" regulations applied in Rev. Rul. 59-58 and the *Hallmark* case.

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[2] The Tax Reform Act of 1986 (Public Law 99-514, § 123) amended Code § 102, effective January 1, 1987, by adding Code § 102(c), which provides that any amount transferred "by or for an employer to, or for the benefit of, an employee," shall not be excluded from gross income under Code § 102(a).

Whether a gift coupon is "redeemable in cash" is not determinative of whether a gift coupon is a "cash equivalent fringe benefit" for Income Tax Regulation § 1.132-6(c) purposes. Neither the statute nor the regulations pertaining to de minimis fringe benefits define a cash equivalent fringe benefit as one that can be readily converted to cash. Instead, we look to the language of Code § 132(e) which requires a determination of whether it is administratively impracticable to account for the gift coupons provided in this case. *See American Airlines, Inc. v. U.S.*, 204 F.3d 1103, 1112 (Fed. Cir. 2000) (upholding the Court of Federal Claims determination that the plaintiff's refund should be denied where "American has not offered evidentiary support for its assertion of administrative impracticability"). There are no facts that indicate it is administratively impracticable for the Taxpayer to properly account for an employer-provided holiday gift coupon with a face value of thirty-five dollars that is redeemable at several local grocery stores. When an employee attends a staff meeting where two pots of coffee and a box of doughnuts are provided by the employer, the value of the benefit the employee receives is not certain or easily ascertained. Further, the administrative costs associated with determining the value of the benefit and accounting for it may be more expensive than providing the benefit. In this case, there is no difficulty in determining the value or accounting for it; each employee that received a gift coupon received a cash equivalent fringe benefit worth thirty-five dollars.

The Taxpayer also suggests that the Income Tax Regulation § 1.274-3(b)(iv) definition of tangible personal property should be applied in this case. Income Tax Regulation § 1.274-3(b)(iv) governs the limits of an employer's deduction for certain employer provided length of service awards and safety achievement awards. Under this regulation, the definition of tangible personal property (for amounts less than $100) "does not include cash or any gift certificate other than a nonnegotiable gift certificate conferring only the right to receive tangible personal property." Additionally, by reference to Income Tax Regulation § 1.274-5(c)(2)(iii)(A)(2) which provides substantiation requirements in connection with the deduction of certain business expenses, the Taxpayer suggests that property with a value of less than seventy-five dollars is de minimis for the purposes of Code § 132(e).

We decline to accept the Taxpayer's arguments that these provisions, which generally impose limits on the deduction of business-related entertainment, meal and gift expenses and also provide substantiation requirements that taxpayers must meet in order to prove that certain business expenses were in fact paid or incurred, have any application in determining whether an item constitutes a de minimis fringe benefit under Code § 132(e). We note specifically that Taxpayer's contention that "it would seem that items of less than $75 in value would … be considered de minimis" is inconsistent with Code § 132(e) which requires a determination of value relative to the frequency with which a particular benefit is provided.

A copy of this technical advice memorandum is to be given to the Taxpayer. Code § 6110(k)(3) provides that it may not be used or cited as precedent.