Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:ITA:1 – PLR-145990-01
Date: 4/10/02

LEGEND:

Taxpayer =
Company =
The Brand card =

Dear

This responds to your letter dated August 9, 2001, supplemented by correspondence on November 2, 2001, November 30, 2001, December 21, 2001, January 29, 2002, March 4, 2002, and April 2, 2002, in which you request rulings related to §§ 61 and 170 of the Internal Revenue Code.

ISSUES

Your ruling request presents the following issues:

1. Does Taxpayer, as a Company cardholder, make a charitable contribution under § 170 when a rebate – a percentage of the price of an item (less an administration fee) purchased with a Company card at a participating merchant – is transferred to a qualified charitable organization?

2. In what tax year can Taxpayer claim a deduction under § 170 for rebates transferred by Company to a charitable organization?

3. Does § 170(f)(8) apply to amounts transferred by Company to a charitable organization?

4. Does Taxpayer realize income from participation in the program?

CONCLUSIONS

1. If Taxpayer, using one of the procedures described in this ruling letter, makes an affirmative election to donate merchant rebates to charity rather than receive them personally, rebates transferred to charity pursuant to that election are charitable contributions, deductible by Taxpayer to the extent provided by § 170. Unless and

until Taxpayer makes such an election, the rebates, even if they are transferred to charity, are not charitable contributions and are not deductible.

2. Taxpayer is entitled to a charitable contribution deduction under § 170 in the year that Company transfers the rebate to charity.

3. Taxpayer must be able to substantiate amounts of $250 or more that are transferred in a lump sum from Company to a particular charity. The substantiation must be by a written acknowledgment from the recipient charity that satisfies the requirements of § 170(f)(8).

4. The rebates are not includible in Taxpayer's gross income, whether they are donated to charity or retained personally.

FACTS

Taxpayer is an individual who itemizes deductions on Schedule A of his federal income tax return. Taxpayer is the of Company.

Company is a for-profit corporation that has developed a brand-name affinity credit card program (the Program), and owns intellectual property and know-how in connection with the Program. Company intends to implement the Program by entering into agreements with banks, merchants, cardholders, and charitable organizations eligible to receive deductible contributions under § 170(c) of the Internal Revenue Code (charities).

Company's Program will use the brand-name affinity credit card (the Brand card) to help charities raise funds in two ways: (1) through basis point donations made by issuing banks in connection with all general credit card purchases; and (2) through additional amounts, referred to for purposes of this ruling as "rebates," furnished by participating local and national retail merchants to Company or its agent banks.[1]

1. Basis Point Donations

Bank basis point donations will be made as a fixed, relatively small percentage of each credit card transaction.[2] Cardholders will have the ability to designate a charity or charities to receive these donations, and will be notified of the amounts of these donations in an annual or semi-annual statement (Statement). However, unlike rebates these amounts will not be available to cardholders and will not be deductible by cardholders as charitable contributions for tax purposes. Explanations of the basis point component of the Program, and any Statement furnished to cardholders showing the amount of their basis point donations, will state that they are not deductible.

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[1] References to "Company" in this discussion include its agent banks where applicable.

[2] An annual fee may be charged to cardholders by the issuing bank, and the annual fee, if charged, will be retained by the issuing bank and will not be a part of the revenue transferred to the charity.

2. Rebates

a. In General

In connection with the merchant rebate component of the Program, Company will enter into contracts with individual merchants under which the merchants will transfer to Company an agreed-upon percentage of the revenue generated by purchases made with the Brand card. Company will inform cardholders of the percentage of the total purchase price that each participating merchant will rebate, and the Program will offer cardholders the ability to make purchases either at the physical locations of merchants or over the Internet.

After a sale by a participating merchant to a cardholder, the agreed-upon rebate will be transferred from the merchant to Company. Of this amount, an administration fee will be retained by Company.[3] The balance of the rebate will be held in a non-interest-bearing custodial account maintained by Company for a period of 30 to 60 days to allow for charge-backs, returns, and dispute resolution. During this period, cardholders who return merchandise or purchases will receive a credit on their account, which will in turn reduce the applicable bank basis point donations and rebates to be contributed to the designated charity or charities.

Within the later of 90 days of the transaction or 60 days after receipt of the funds, the balance of the rebates will be distributed to a charity or charities, or to the cardholder, in accordance with the election procedures described below. Once funds are transferred to a charity, the transfer is irreversible. Even in the event of a customer's subsequent return of merchandise, warranty claim, or similar occurrence, rebates associated with the item and already paid to a charity will not be returned to the cardholder, Company, or the merchant.

Cardholders who elect to donate rebates will receive nothing from Company in exchange for the distribution of the rebates to their designated charity. Apart from the differences described in this ruling letter concerning the handling of basis points, rebates and disclosures to cardholders, Taxpayer represents that cardholders who choose to donate rebates to charity and cardholders who choose to retain rebates personally will receive identical treatment with respect to the frequency and amount of rebates given, special offers, interest rates, credit limits, termination, and other terms of service.

Under § 170(f)(8) of the Code, no deduction is allowed for a charitable contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution, as described in § 170(f)(8) and § 1.170A-13 of the Income Tax Regulations. For cardholders who elect to donate

[3]No portion of the administration fees retained by Company will be reported to cardholders as a charitable contribution, and no charitable contribution deduction will be allowed for these retained administration fees.

rebates to charity, Company intends to supply donee charitable organizations with information concerning the amounts of the cardholder's contributions, as well as the name and address of the cardholder, so that charitable organizations will be able to provide the substantiation required by § 170(f)(8) in a timely manner.

Company intends that the Brand card will acquire participant cardholders in two ways: (1) direct solicitation by participating charities; (2) an "overlay method" under which participating banks offer the Program, on either an automatic or opt-in basis, as an "added benefit" for all cardholders in an existing portfolio.

In both cases, Company will institute procedures described below (Procedures), intended to ensure that, before a participating cardholder can claim a charitable contribution deduction for rebates, the cardholder has indicated in an unambiguous and affirmative manner that the cardholder is aware of the right to receive the rebates personally and has instead made a voluntary election (Election) to contribute those rebates to a charitable organization or organizations.

b. Direct Solicitation Procedures

i. Election in Application

When an individual joins the Program as the result of direct solicitation by a participating charity, the Election will normally be contained on the application for the card. The application will inform the cardholder that the rebates may either be donated to the soliciting charity (or to another charity or charities participating in the Program) or retained by the cardholder. The Election will state that if the cardholder chooses to donate rebates, the rebates may be deductible for federal tax purposes if the cardholder itemizes deductions. The Election will also inform cardholders that if they choose to retain rebates, the rebates are not deductible. Both options will be presented together, in the same typeface and font. The applicant cardholder will be required to indicate affirmatively – for example, by checking an empty box – which of the two options the cardholder intends to select.

If the cardholder elects to retain rebates personally, rebates will be credited back to the cardholder's account by Company. In such a case, any Statement showing the amount of rebates earned by the cardholder will state that they are not deductible. If the cardholder elects to donate the rebates to a charity, rebates will be transferred from participating merchants to Company and subsequently transferred to the charity as described above. Cardholders who elect to donate will be notified, typically in a year-end Statement, of the amount of rebates transferred to the charity and will be informed that those amounts are deductible, subject to the requirements and limitations of the Internal Revenue Code. If no affirmative election is made, rebates will still be accumulated and transferred to the soliciting charity, and the cardholder will be informed of the transferred amounts. In this case, however, any Statement showing rebate amounts transferred to the charity will inform the cardholder that the rebate amounts, like the basis point donations, are not deductible.

ii. Election in "Welcome Letter"

Because of the number of issuing banks that may be involved, and because of possible legal restrictions concerning disclosures on credit card applications, Company cannot represent that the Election will always be included directly on the application. If it is not, then the Election will be included in a subsequent "Welcome Letter" from Company to the individual cardholder. Company will be able to track applications that have or have not included the Election, and will provide the Welcome Letters accordingly.

An Election included in a Welcome Letter will be substantially the same as an Election included in an application: it will inform cardholders of their option either to donate or retain rebates, and the corresponding tax consequences. Both options will be presented together, in the same typeface and font. The applicant cardholder will be asked to indicate affirmatively which option the cardholder intends to select – for example, by checking an empty box on the Welcome Letter or on a reply card – and to return the Election to Company. The "default" procedure, unless and until a cardholder responds, will be that rebates are transferred to the soliciting charity; however, any rebates that accrue prior to the receipt and processing of a cardholder's Election will not be deductible, and any Statement that is furnished to the cardholder will indicate clearly which amounts are deductible and which are not.

ii. Election on Website

Company maintains a website on the Internet. Prospective cardholders will be able to apply for an account using the website, and will be able to make the Election on the website. The manner of presenting the Election, the options offered, and the Procedures Company will follow will be substantially the same as in the case of an Election included on a paper application or in a Welcome Letter. For example, the option either to donate or retain rebates will be presented together, in the same typeface and font, and the applicant cardholder will be asked to indicate affirmatively which option the cardholder intends to select.

iii. Effect of Election and Change of Election

An Election (or the default procedure in the absence of an affirmative Election) will remain in effect for all purchases and rebates until Company receives affirmative notification of a subsequent Election or change of Election. For example, a cardholder who elects to donate rebates to a charity cannot change that Election on a purchase-by-purchase basis, or with respect to purchases that have already been made. However, a cardholder will be able to make or change an Election for future purchases at any time, through a procedure that is not unduly burdensome, reflects an affirmative choice by the cardholder, and is disclosed at the time of, and in the same manner as the original Election. Methods of making or changing an Election may include, for example, mail, e-mail, use of the website, or an automated telephone/PIN number method. If a method is provided for electing to donate rebates to charity, a cardholder will be able to elect to retain rebates personally using the same method. An Election or

change of Election will apply to rebates accruing after the Election is received and processed by Company.

For example, a cardholder may change the designation of the charity to which rebates are donated, or the cardholder may elect to retain the rebates personally instead. In the latter case, rebates received after Company receives and processes the change of election will be credited back to the cardholder's account and will be identified as nondeductible in any Statement furnished to the cardholder. Similarly, a cardholder who originally elected to retain the rebates, or made no affirmative election, may subsequently make an affirmative election to waive the right to receive the rebates and donate them to a charity or charities. In this case, only rebates received after Company receives and processes the notification will be identified as deductible.

c. "Overlay" Method Procedures

Under the overlay method, participating banks will be given the option either to: (1) have all their existing and new cardholders entered into the Program as an "added benefit" to their other card privileges; or (2) create the opportunity for each existing and new cardholder to join the Program on an "opt-in" basis.

If the bank elects to join the Program on an added benefit basis, there will be no opportunity to advise existing cardholders in advance about the Program. The cardholder will receive notification of the added benefit in a Welcome Letter, which will advise the cardholder of the Election, in the same manner as described above for Welcome Letters that are sent in connection with a direct solicitation. For prospective cardholders, the Election will be disclosed either in the application, where possible, or in a Welcome Letter, in the same manner as in the case of a direct solicitation.

If the participating bank elects to provide the Program as an "opt-in" benefit, the cardholder will not be enrolled into the Program until an Election is made.

The overlay method differs from the direct solicitation method in that, in the absence of an election by a cardholder to donate rebates to a specific charity, the default will be that rebates will be contributed to a pool of charities participating in the Program in the local community. A cardholder making an Election will be able to choose between directing the rebates to a particular charity, to the pool, or to the cardholder personally.

In all other respects, the overlay method will function in the same manner as the direct solicitation method. In particular, cardholders will be advised that basis point donations are never deductible, and only rebates that are transferred to charities after the cardholder makes an affirmative Election are deductible.

3. Taxpayer's Election

Taxpayer intends to enroll in the Program and, using one of the Procedures described above, elect to donate rebates generated through purchases from participating

merchants to a participating charitable organization that is eligible to receive tax deductible contributions under § 170.

LAW AND ANALYSIS

Ruling Request #1 – Charitable contribution under § 170.

Taxpayer first asks us to rule that under the following circumstances he has made a donation that is a charitable contribution deductible under § 170 of the Code: (1) by using a Procedure described above, Taxpayer elects to donate rebates generated by his purchases made by Brand card to charity; (2) after making the Election, Taxpayer purchases merchandise from a participating merchant using a Brand card; and (3) Company receives a rebate from the participating merchant, which it subsequently pays over to charity.

A charitable contribution must be made voluntarily and with donative intent. U.S. v. American Bar Endowment, 477 U.S. 105 (1986). In American Bar Endowment, a membership organization maintained a group insurance program for its members. As a condition of participating in the insurance program, members were required to assign refunds from their premiums to the organization. Every year, a portion of the insurance premiums paid by members was refunded to the organization. The organization used these refunds to fund charitable grants. Members participating in the group insurance program claimed charitable contribution deductions under § 170 for their pro-rata shares of the refund amounts that funded charitable activities.

The Supreme Court concluded that there was no voluntary payment of money or property. The Court held that since the members could not demonstrate that they had intentionally contributed money in excess of the value of the insurance they received, they were not allowed a charitable contribution deduction. Although one member demonstrated that he was eligible for an insurance program that offered lower premiums, he did not establish donative intent because he failed to show that he was *aware* of that alternative during the years at issue. 477 U.S. at 118. The Court suggested that it would have reached a different result if the organization were to give each member a choice between retaining the member's pro-rata share of dividends or assigning them to the organization. Id. at 113.

Rev. Rul. 70-419, 1970-2 C.B. 5, holds that a taxpayer may deduct the amount of a State tax refund to which it is entitled but for which it does not file an application, provided the State is affirmatively notified of the gift by the taxpayer. Where no affirmative action is taken by the taxpayer, and the statute of limitations within which to file the application for refund is allowed to expire, no charitable deduction under § 170 is allowed.

In the present case, Taxpayer will have the choice referred to in American Bar Endowment: he will have the opportunity to donate the rebates held by Company on his behalf to a charity, or to direct Company to pay them to him. Company has instituted procedures to ensure that, before a participating cardholder can claim a charitable

contribution deduction for rebates, the cardholder has indicated in an unambiguous and affirmative manner that the cardholder is aware of the right to receive the rebates personally and has instead made a voluntary election to contribute those rebates to charity. See American Bar Endowment, 477 U.S. at 118; Rev. Rul. 70-419. Once he elects to donate rebates to charity, Taxpayer will not be able to change that election on a purchase-by-purchase basis, or with respect to purchases that have already been made. However, Taxpayer will be able to change his election at any time for future purchases.

This element of choice distinguishes the Company program from the group insurance program at issue in American Bar Endowment, where those who wished to participate in the group insurance program could not decline to have their premium refunds transferred to a charitable organization. The opportunity to decide whether rebates will be made to a charity or received personally, and the affirmative decision to donate the rebates, render the payments voluntary. By contrast, the Program's bank basis point donations are not deductible by Taxpayer – even though Taxpayer can designate the recipient charity – because Taxpayer never has the option to receive those amounts personally.

If Taxpayer complies with the substantiation requirements under § 170(f)(8) and all of the other requirements of § 170, he will be allowed a charitable contribution deduction for the donation of his rebate.

Ruling Request #2 – Year of deduction.

Rev. Rul. 78-38, 1978-1 C.B. 67, holds that a charitable contribution effected by means of a bank credit card is deductible in the year the charge is made. However, in the present case, although the charitable contribution arises as a result of Taxpayer's purchase of an item using a credit card, the charitable contribution is not actually made by use of the card.

Rev. Rul. 55-192, 1955-1 C.B. 294, concludes that the portion of a social club's membership dues earmarked by a taxpayer for distribution to a qualified charity and paid to the club's treasurer may give rise to a deductible charitable contribution. Because the social club's treasurer also serves as an authorized agent of the donee charitable organization, the ruling allows the deduction in the year the dues are paid to the treasurer. The ruling states that, if the treasurer had not been designated by the charitable organization as its agent, the contributions would have been deductible only in the year in which they were actually transferred to the charitable organization.

In Rev. Rul. 85-184, 1985-2 C.B. 84, a utility company enters into an agreement with a local chapter of a charitable organization to collect contributions for a program providing emergency energy assistance to elderly and handicapped persons. The charity designates the utility company as its authorized agent to collect contributions on the charity's behalf. Utility company customers are given the opportunity to make contributions to the emergency energy assistance program by making payments to the utility company in an amount, earmarked by the customer for donation, in excess of

their monthly bills. The revenue ruling holds that customers making such extra payments are entitled to a deduction for a charitable contribution under § 170. As the utility company is acting as the agent for the charity, Rev. Rul. 85-184 holds that the deduction is allowed in the taxable year the extra payment is made to the utility company.

A charitable contribution paid to an agent of a charitable organization is deductible when paid to the agent. Section 1.170A-1(b) of the Income Tax Regulations. See also Rev. Rul. 55-192 and Rev. Rul. 85-184. In the present case, however, Company does not serve as the agent for a charity with respect to merchant rebates. During the time the rebates are held by Company, they are available in the event of any charge-back, return, or dispute resolution connected with the purchase; thus, Taxpayer retains a degree of control and benefit with respect to the funds. A charity does not have an absolute right to any rebates until Company actually transfers the amounts to the charity. In substance, Company is acting on behalf of Taxpayer, not the recipient charity, until the rebates are transferred to the charity.

Delivery to a third party, for subsequent delivery to a charitable organization, does not satisfy the requirement of delivery. Londen v. Commissioner, 45 T.C. 106 (1965); Steele's Mills v. Commissioner, 4 B.T.A. 960 (1926). There is no delivery of a charitable contribution when Company receives an amount on behalf of Taxpayer. Delivery occurs when Company transfers the amount to the recipient charity.

Therefore, Taxpayer will be entitled to claim a charitable contribution deduction for the tax year in which Company transfers rebates it holds on Taxpayer's behalf to the recipient charity.

Ruling Request #3 – Application of § 170(f)(8).

Section 170(f)(8)(A) provides that no deduction is allowed under § 170 for a contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of § 170(f)(8)(B).

If Company makes a lump-sum transfer of $250 or more to a charity, Taxpayer must have the substantiation required by § 170(f)(8). Because, as stated above, the donation occurs when Company transfers the amount to the recipient charity, a payment of $250 or more is subject to § 170(f)(8) even if it is the aggregate of separate rebates. Company will supply all participating charities with the information necessary for the charities to provide the required substantiation.

Ruling Request #4 – Rebates not included in income.

A rebate received from the party to whom the buyer directly or indirectly paid the purchase price for an item is a reduction in the purchase price of the item; it is not an accession to wealth and is not includible in the buyer’s gross income. Rev. Rul. 76-96, 1976-1 C.B. 23; Rev. Rul. 84-41, 1984-1 C.B. 130.

In this case, when Taxpayer purchases a product from a participating merchant, Company receives from the merchant a rebate on behalf of Taxpayer. Taxpayer may elect to receive rebates personally, or donate them to a charity. Regardless of Taxpayer's election, this rebate constitutes a reduction in the purchase price of the product that, pursuant to Rev. Rul. 76-96 and Rev. Rul. 84-41, is not includible in Taxpayer's gross income.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. For example, no opinion is expressed about the tax consequences of the Program to Company or to participating merchants, banks, or charities.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
PAUL M. RITENOUR
Chief, Branch 1
Office of Associate Chief Counsel
(Income Tax & Accounting)