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State of South Carolina  
**Department of Revenue**  
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SC PRIVATE LETTER RULING #11-5

**SUBJECT:** Loyalty Points Program – Cellular Telephone Provider  
(Sales and Use Tax)

**REFERENCES:** S. C. Code Ann. Section 12-36-910 (2000; Supp. 2010)  
S. C. Code Ann. Section 12-36-1310 (2000; Supp. 2010)  
S. C. Code Ann. Section 12-36-1110 (Supp. 2010)  
S. C. Code Ann. Section 12-36-90 (2000; Supp. 2010)  
S. C. Code Ann. Section 12-36-130 (2000; Supp. 2010)  
S. C. Code Ann. Section 12-36-60 (2000)

**AUTHORITY:** S. C. Code Ann. Section 12-4-320 (2000)  
S. C. Code Ann. Section 1-23-10(4) (2010)  
SC Revenue Procedure #09-3

**SCOPE:** A Private Letter Ruling is an advisory opinion issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. It is the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

Questions:

1. Does the issuance of loyalty points to a subscriber under a JKL Company "123 Plan" affect the taxability of the wireless monthly fees paid by a "123 Plan" subscriber based on any imputed value of the loyalty points issued?
2. When loyalty points are exchanged under a JKL Company "123 Plan" for discounts on the sale of tangible personal property, is the value allowed for the loyalty points used for the discount subject to the tax as part of the "gross proceeds of sales" or "sales price" of the tangible personal property?

3. When a subscriber of a JKL Company “123 Plan” receives a discount of 3% or 5% on the wireless monthly fee for automatically paying online and accepting paperless billing, is the discount allowed for automatically paying online and accepting paperless billing a part of the “gross proceeds of sales” or “sales price” of the wireless monthly fee and subject to the sales and use tax?

Conclusions:

1. The issuance of loyalty points to a subscriber under a JKL Company “123 Plan” does not affect the taxability of the wireless monthly fees paid by a “123 Plan” subscriber based on any imputed value of the loyalty points issued.

In other words, the fact that JKL Company issues loyalty points under a “123 Plan” does not increase or decrease the “gross proceeds of sales” or the “sales price” of the wireless monthly fee subject to the sales and use tax based on any imputed value of the loyalty points issued.

Note: See Conclusion #2 for the application of the tax when loyalty points are exchanged for discounts on sales of tangible personal property as defined in Code Section 12-36-60 and as described in the facts (*e.g.*, phones, accessories, and communications services).

2. When loyalty points are exchanged under a JKL Company “123 Plan” for discounts on the sale of tangible personal property, the value allowed for the loyalty points used for the discount is not a part of the “gross proceeds of sales” or “sales price” of the tangible personal property and is therefore not subject to the sales and use tax. In other words, the “gross proceeds of sales” or “sales price” of the tangible personal property subject to the sales and use tax does not include the discount allowed for the “123 Plan” loyalty points.

For example, if a cell phone otherwise sells for \$200, but a “123 Plan” subscriber can purchase the cell phone for \$175 by exchanging a certain number of loyalty points, then the “gross proceeds of sales” or “sales price” upon which the tax is calculated is \$175.

However, since the use of loyalty points under a JKL Company “123 Plan” allows a customer to purchase phones and other tangible personal property for as little as one cent, the provisions of the sales tax concerning “withdrawals for use” are applicable. It is the opinion of the Department that where tangible personal property is purchased by JKL Company for resale and is transferred from JKL Company to a customer for no consideration, a nominal consideration, or an amount significantly below cost, the tangible personal property is considered a promotional item withdrawn from inventory and used or consumed by JKL Company. The presumption that tangible personal property sold for an amount that is a nominal consideration, or an amount that is significantly below cost, is a promotional item withdrawn from inventory and used and consumed by the retailer may be rebuttable for clearance sales, end-of-season sales, fire sales, going-out-of-business sales, two-for-one sales, and other traditional store sales where the retailer can document that the transaction is a “true” sale and not a promotional give-away.

If the tangible personal property is considered a promotional item withdrawn for inventory and used or consumed by JKL Company, then JKL Company is liable for the sales tax on the withdrawal for use based on the fair market value of the tangible personal property (Code Sections 12-36-110(1)(c) and 12-36-90(1)(c)), unless otherwise exempt or excluded from the tax.

For example, if a cell phone sells for \$200, but a “123 Plan” subscriber can purchase the cell phone for \$0.01 by exchanging a certain number of loyalty points, then the cell phone is considered a promotional item withdrawn for inventory and used or consumed by JKL Company that is subject to the tax based on its fair market value of \$200.

3. When a subscriber of a JKL Company “123 Plan” receives a discount of 3% or 5% on the wireless monthly fee for automatically paying online and accepting paperless billing, the discount allowed for automatically paying online and accepting paperless billing is not a part of the “gross proceeds of sales” or “sales price” of the wireless monthly fee and therefore not subject to the sales and use tax.

Facts:

ABC of South Carolina Inc., an operating subsidiary of XYZ Corporation, (“JKL Company”) provides wireless telecommunications service in South Carolina, including voice service, text and picture messaging service, and data service.

JKL Company has recently redesigned its wireless telecommunications service plans and introduced them under the name “123 Plans.” The 123 Plans transform the relationship between JKL Company and its customers from the historic contract-based relationship to a loyalty-based relationship. JKL Company introduced a points-based loyalty awards program that is included with its 123 Plans. Subscribers to these plans accrue points over time which can be exchanged for 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 123 Plans, JKL Company 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 on-line.

In the past, JKL Company offered to 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 (the “wireless monthly fee”), 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 (“overage”). When a customer’s contract period was up, 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 October 1, 2010, JKL Company unveiled the 123 Plans referenced above. At the core of the 123 Plans is a new points-based customer loyalty program (the “Loyalty Program”). When a new customer signs up for a 123 Plan, he is automatically enrolled in the Loyalty Program at the same time, for no additional charge. Under the terms of the 123 Plan, this 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 wireless monthly fee includes a set number of (or in some cases, unlimited) voice minutes and/or text and picture messages that the 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 123 Plans for the duration of the contract. At the end of the initial two-year 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 every 18 months, as long as he remains a 123 Plan subscriber. Unlike JKL Company’s former practice, a customer enrolled in the Loyalty Program is not required to sign a new two-year contract to receive this new discounted phone. Rather, every 18 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 points. A customer earns loyalty points as follows: every six months based on the length of time he has been enrolled in the Loyalty Program; each month based on the 123 Plan he 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 JKL Company; and for referring other customers. Also, an existing JKL Company customer who signs up for a 123 Plan will receive a one-time award of “loyalty bonus” points.

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

Once accrued, a customer can exchange points for a discount on a new phone; a discount on phone accessories (cases, extra batteries, covers, etc.); for free ringtones and ringback services; to add 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 [some or all 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 18-month period expires (“Phone Acceleration”). Under the loyalty points program customers may exchange points for significant discounts; however, points cannot discount the price of phones or tangible accessories to less than one cent. The only means by which JKL Company permits a customer to obtain Phone Acceleration is by redeeming loyalty points; JKL Company does not charge for or otherwise permit a customer to accelerate a discounted phone purchase.

A customer can redeem 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 JKL Company-owned store, a JKL Company store owned by an independent agent, or call JKL Company 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.

JKL Company has also introduced a program under which a customer receives a three percent discount (for payment with a debit or credit card) or a five percent discount (for payment by direct debit from the customer’s checking account) on the price of his wireless monthly fee each month if he sets up automatic online bill payment with paperless billing.

Discussion:

Code Section 12-36-910(A) imposes “a sales tax, equal to [six] percent of gross proceeds of sales, upon every person engaged ... within this State in the business of selling tangible personal property at retail.”

Code Section 12-36-90 defines the term “gross proceeds of sales” and reads, in part:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property.

(1) The term includes:

\* \* \* \*

(b) the proceeds from the sale of tangible personal property without any deduction for:

- (i) the cost of goods sold;
- (ii) the cost of materials, labor, or service;
- (iii) interest paid;
- (iv) losses;
- (v) transportation costs;
- (vi) manufacturers or importers excise taxes imposed by the United States; or
- (vii) any other expenses.

(2) The term does not include:

- (a) a cash discount allowed and taken on sales;

\* \* \* \*

Code Section 12-36-1310(A) imposes the use tax at the rate of six percent of the sales price of the property “on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State.”

Code Section 12-36-130 defines the term “sales price” and reads:

"Sales price" means the total amount for which tangible personal property is sold, without any deduction for the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses, or any other expenses.

(1) The term includes:

- (a) any services or transportation costs that are a part of the sale, whether paid in money or otherwise; and
- (b) any manufacturers or importers excise tax imposed by the United States.

(2) The term does not include:

- (a) a cash discount allowed and taken on the sale;

\* \* \* \*

In addition, it should be noted that Code Section 12-36-60 defines the term "tangible personal property" to include “services and intangibles, including communications, ... , the sale or use of which is subject to tax under this chapter ....” Communications services are subject to sales and use taxes under Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3), which impose the tax on the “gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or messages ....”

Based on the above, sales at retail of tangible personal property, which includes by definition certain communications services such as cellular telephone service, are subject to the sales and use tax.

The sales tax is based on the “gross proceeds of sales” of the tangible personal property, and the use tax is based on the “sales price” of tangible personal property, which do not include discounts where the retailer will not receive any consideration for the discount.

In summary, with respect to a self-redeeming loyalty points program as described in the facts, the “gross proceeds of sales” or “sales price” is the amount paid by the “123 Plan” subscriber for the tangible personal property (e.g., a discounted telephone, a discounted telephone accessory and a discounted wireless monthly fee).<sup>1</sup>

For example, if a cell phone otherwise sells for \$200, but a “123 Plan” subscriber can purchase the cell phone for \$175 by exchanging a certain number of loyalty points, then the “gross proceeds of sales” or “sales price” upon which the tax is calculated is \$175.

However, the question now arises as to whether an item “sold” at a discount price of one cent, or some other discounted price far below the items cost, is a sale or a promotion.

Code Section 12-36-110, defines the terms “retail sale” and “sale at retail” to mean, in part:

Sale at retail and retail sale mean all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

\* \* \* \*

(1) The terms include:

\* \* \* \*

(c) the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale, except:<sup>2</sup>

- (i) withdrawal of tangible personal property previously withdrawn and taxed by such business or person,
- (ii) tangible personal property which becomes an ingredient or component part of tangible personal property manufactured or compounded for sale,
- (iii) tangible personal property used directly in manufacturing, compounding, or processing tangible personal property for sale,
- (iv) materials, containers, cores, labels, sacks, or bags used incident to the sale and delivery of tangible personal property;
- (v) a motor vehicle operated with a dealer, transporter, or manufacturer, or education license plate and used in accordance with the provisions of Section 56-3-2320 or 56-3-2330; (Emphasis added.)

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<sup>1</sup> For a discussion of the application of the sales and use tax to a retail sales transaction where the retailer is reimbursed for a discount provided to a customer, such as the use of a manufacturer’s coupon, see SC Revenue Ruling #99-9. SC Revenue Ruling #99-9 also addresses the application of the sales and use tax to self-redeeming coupons, which are analogous to the loyalty points program described in this private letter ruling.

<sup>2</sup> The exceptions listed in this provision are not discussed in this document for purposes of simplifying the discussion.

Code Section 12-36-120 defines the terms “wholesale sale” and “sale at wholesale” to mean, in part, a sale of:

... tangible personal property to licensed retail merchants, jobbers, dealers, or wholesalers for resale, and do not include sales to users or consumers not for resale;

Based on the above, a “retail sale” includes:

- (1) the withdrawal of tangible personal property by anyone who purchased it at wholesale;
- (2) the use of tangible personal property by anyone who purchased it at wholesale; or,
- (3) the consumption of tangible personal property by anyone who purchased it at wholesale.

Code Section 12-36-90 defines the term “gross proceeds of sales,” which is the basis for calculating the sales tax, in part as:

... the value proceeding or accruing from the sale, lease, or rental of tangible personal property.

(1) The term includes:

\* \* \* \*

(c) the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business or used or consumed by any person withdrawing it, except for:<sup>3</sup>

- (i) withdrawal of tangible personal property previously withdrawn and taxed by such business or person;
- (ii) tangible personal property which becomes an ingredient or component part of tangible personal property manufactured or compounded for sale;
- (iii) tangible personal property replacing defective parts under written warranty contracts if:
  - (A) the warranty, maintenance, service, or similar contract is given without charge, at the time of original purchase of the defective property, or the tax was paid on the sale or renewal of warranty, maintenance, or similar service contract for tangible

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<sup>3</sup> The exceptions listed in this provision are not discussed in this document for purposes of simplifying the discussion.

personal property of which the defective part was a component, whether or not such contract was purchased in conjunction with the sale of tangible personal property,

(B) in the case of a warranty, maintenance, service, or similar contract that is given without charge at the time of original purchase of the defective property, the tax was paid on the sale of the defective part or on the sale of the property of which the defective part was a component, and

(C) the warrantee is not charged for any labor or materials,

(iv) an automobile furnished without charge to a high school for use solely in student driver training programs;

(v) a new motor vehicle used by a dealer as a demonstrator.

(Emphasis added.)

Therefore, tangible personal property purchased at wholesale is subject to the sales tax based upon its fair market value<sup>4</sup> when it is (1) withdrawn from the business or stock and (2) used or consumed in connection with the business or used or consumed by the person withdrawing it.

Based on the above, it is the opinion of the Department that where tangible personal property is purchased by a retailer for resale and is transferred from the retailer to a customer for no consideration, a nominal consideration, or an amount significantly below cost, the tangible personal property is considered a promotional item withdrawn for inventory and used or consumed by the retailer.

If the tangible personal property is considered a promotional item withdrawn for inventory and used or consumed by the retailer, then the retailer is liable for the sales tax on the withdrawal for use based on the fair market value of the tangible personal property (Code Sections 12-36-110(1)(c) and 12-36-90(1)(c)), unless otherwise exempt or excluded from the tax.

For example, if a cell phone sells for \$200, but a “123 Plan” subscriber can purchase the cell phone for \$0.01 by exchanging a certain number of loyalty points, then the cell phone is considered a promotional item withdrawn for inventory and used or consumed by JKL Company that is subject to the tax based on its fair market value of \$200.

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<sup>4</sup> SC Regulation 117-309.17, concerning withdrawals from stock by merchants, states:

To be included in gross proceeds of sales is the money value of property purchased at wholesale for resale purposes and subsequently withdrawn from stock for use or consumption by the purchaser.

The value to be placed upon such goods is the price at which these goods are offered for sale by the person withdrawing them. All cash or other customary discounts which he would allow to his customers may be deducted; however, in no event can the amount used as gross proceeds of sales be less than the amount paid for the goods by the person making the withdrawal.

The presumption that tangible personal property sold for an amount that is a nominal consideration, or an amount that is significantly below cost, is a promotional item withdrawn from inventory and used and consumed by the retailer may be rebuttable for clearance sales, end-of-season sales, fire sales, going-out-of-business sales, two-for-one sales, and other traditional store sales where the retailer can document that the transaction is a “true” sale and not a promotional give-away.

Finally, the issuance of loyalty points to a subscriber under a JKL Company “123 Plan” does not affect the taxability of the wireless monthly fees paid by a “123 Plan” subscriber based on any imputed value of the loyalty points issued. In other words, the fact that JKL Company issues loyalty points under a “123 Plan” does not increase or decrease the “gross proceeds of sales” or the “sales price” of the wireless monthly fee subject to the sales and use tax based on any imputed value of the loyalty points issued.

As discussed above, loyalty points will only affect the amount upon which the tax is calculated when they are exchanged for discounts on sales of tangible personal property as defined in Code Section 12-36-60 and as described in the facts (*e.g.*, phones, accessories, and communications services).

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/James F. Etter

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James F. Etter, Director

September 26, 2011  
Columbia, South Carolina