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November 2, 2011

Mr. Ben Edelman
Harvard Business School
Soldiers Field
Boston, MA 02163

Dear Mr. Edelman:

This is in response to your May 23, 2011 letter received in this office on June 13, 2011, in which you requested information on the application of California's sales and use tax law to purchases made with Groupon discount vouchers. I apologize for the lengthy delay in responding to your correspondence. We were waiting for a response from our Legal Department on how tax applies to sales of deal-of-the-day instruments offered through third-party internet-based companies (e.g., Groupon, Living Social, etc.).

For your general information, California's sales and use tax law imposes a sales tax upon retailers for the privilege of selling tangible personal property at retail in the State of California and is measured by gross receipts from retail sales. The use tax is complementary (and mutually exclusive) to the sales tax and is imposed upon the storage, use, or other consumption in this state of tangible personal property, not subject to the sales tax. Either the sales or the use tax applies to all retail sales of tangible personal property to consumers in California, unless otherwise exempted by statute or type of transaction. The retailer (seller) is liable for sales tax. The obligation to pay the use tax is on the consumer.

In your letter you inquired about California's sales and use tax treatment to certain online restaurant discount vouchers, specifically those offered by Groupon.com. You provided an example where a consumer pays \$20 on the Groupon web site and receives a printable voucher for \$50 of food at a participating restaurant. The consumer dines at the restaurant, ordering exactly \$50 of food. Groupon reimburses the restaurant \$15 (having deducted a \$5 fee for itself). Specifically you asked should the consumer pay tax on the full amount of the meal (\$50) or only on the amount the consumer actually paid for the Groupon voucher (\$20). Additionally, you provided your analysis of the transaction using Sales and Use Tax Regulation 1671.1, *Discounts, Coupons, Rebates, and Other Incentives*, (copy enclosed).

As you are aware, third-party internet companies (for example Groupon and LivingSocial) offer "deals-of-the-day" which feature coupons that can be redeemed for merchandise or services at local or national companies. For sales and use tax purposes the coupons are considered "deal-of-the-day instruments" (DDI). Customers purchase DDIs on-line at discounted prices which allow

them to purchase a set amount of products and/or services from the retailer offering the “deal-of-the-day.”

In accordance with Regulation 1671.1, DDIs with the following specific terms and conditions are considered retailer coupons (Regulation 1671.1(b)(4)). As such, the retailer is the issuer of the DDI. When the DDI is redeemed for tangible personal property, the retailers’ gross receipts subject to tax include the consideration paid by the customer for the DDI plus any additional cash, credit or other consideration paid to the retailer when the product is purchased.

As noted above, the retailer is the issuer of the DDI thus any amounts retained by the DDI provider with respect to the sale of the DDI are non-deductible costs paid by the retailer to the DDI provider in exchange for services, advertising or otherwise, provided in connection with the sale of the merchandise. (RTC section 6012(a)(2).)

Terms and conditions applicable to transactions involving DDIs:

- Retailers negotiate contracts with the DDI provider (third-party internet-based company) to sell DDIs for a set price that is specified in the contract.
- The contracts provide that the DDI provider receives a certain percentage or dollar amount from the sale of each DDI as compensation for the service of advertising and selling the DDI on the retailer’s behalf and/or the DDI provider markets the DDI as an agent or representative of the retailer. These amounts are non-deductible costs paid by the retailer to the DDI provider in exchange for such services.
- Customers may purchase DDIs with cash, cash equivalents, DDI “bucks”, reward points, loyalty points, or friend referrals.
- Terms and conditions of the DDI include specified limitations on the use of the DDI, for example, the DDI cannot be combined with any other coupons or promotions or with other offers, or it is not valid for certain items, or that the customer must use the DDI in one visit and/or cannot receive cash back for partial redemption.
- An expiration date for the full value of the DDI is printed on the face of the instrument (e.g., 6 months from the date of issuance). However, the amount paid for the DDI generally has a later expiration date, (e.g., one year from date of issuance). As an example, using the above dates, after a DDI is issued it can be redeemed for its full value for 6 months, after which time it can be redeemed for only the amount paid for the DDI for one year from the day of issuance. After the paid value expires, the DDI has zero value.
- The retailer does not provide the customer gift certificates, cash or cash equivalents when the DDI is redeemed.
- DDIs are a single-use instrument and lose all value after the first use.

The purchase of the DDI from a third-party internet company is not regarded as a sale of tangible personal property but merely evidence of an intangible right to receive tangible personal property and thus does not result in a taxable transaction.

As an example and using the information provided in your e-mail, a consumer pays \$20 on the Groupon website and receives a printable DDI valid for \$50 for the purchase of taxable meals at a participating restaurant. The consumer dines at the restaurant and redeems the DDI for exactly \$50 and pays no additional amount for the meals other than the amount for "sales tax." The amount subject to tax is \$20 which equals the amount the consumer paid for the DDI.

As a further example, assume the consumer in the above transaction redeems the DDI to purchase \$90 worth of meals at the restaurant. The amount subject to tax would be \$60.00, which is the amount the consumer paid for the DDI (\$20.00) plus the additional \$40.00 required to be paid by the customer for the taxable meals they purchased from the restaurant (\$90 sales price minus \$50 face value of the DDI).

I hope this information is helpful. Please note that in the near future a *Special Notice* will be available on our website to provide information on the application of tax to Deal-of-the-Day Instruments. If you have any further questions regarding this or any other issue, please write or call our Taxpayer Information Section at (800) 400-7115. You may also visit our website at www.boe.ca.gov.

Sincerely,


Lori J. Mayoya
Business Taxes Specialist

LJM:lsc

Enclosure: Regulation 1671.1