

Generally, the treatment of discounts under the Telecommunications Excise Tax Act is similar to the treatment of discounts under the Retailers' Occupation Tax Act. See 35 ILCS 630/2 and 86 Ill. Adm. Code 130.2125(b). (This is a GIL.)

March 31, 2011

Dear Xxxxx:

This letter is in response to your letter dated November 1, 2010, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

The purpose of this letter ('Letter') is to request a sales, use, and telecommunications tax ruling on behalf of BUSINESS's operating subsidiaries in your state (collectively, 'BUSINESS') under 35 ILCS §§ 120/2 ('Sales Tax'), 105/3 ('Use Tax') and 630/1 ('Telecommunications Tax'). BUSINESS is a holding company that is not licensed to, and does not provide, wireless telecommunications service. Its operating subsidiaries listed in the Appendix to this letter are licensed to, and do provide, wireless telecommunications service in your state, including voice service, text and picture messaging service, and data service; they do so under the trade name 'BUSINESSS'

BUSINESS has recently redesigned its wireless telecommunications service plans and introduced them under the name 'PLANs.' The PLANs transform the relationship between BUSINESS and its customers from the historic contract-based relationship to a customer -based relationship. BUSINESS introduced a points-based program that is included with its 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.<sup>1</sup> In connection with the PLANs, BUSINESS 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.

This Letter specifically requests rulings that no reduction in taxable gross receipts is permitted for the revenue allocated for accounting purposes to the points provided to customers;<sup>ii</sup> that no additional tax is due when points are exchanged for nontaxable goods and services; that Sales Tax or Telecommunications Tax (as appropriate) is due on only the net amount of cash paid when a customer redeems points to receive a discount on tangible goods, or taxable digital goods and services; and that Telecommunications Tax is due only on the discounted amount when a customer pays his bill online.

## BACKGROUND

In the past, BUSINESS 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, BUSINESS unveiled the PLANs referenced above. At the core of the PLANs is a new points-based customer PROGRAM. When a new customer signs up for a PLAN, he is automatically enrolled in the PROGRAM at the same time, for no additional charge. Under the terms of the PLAN, this new customer signs an initial two-year contract and has the opportunity to buy a phone for a significant discount, sometimes for a little as one cent, at the time of enrollment. No further contract is required after the first two-year contract commitment is completed.<sup>iii</sup>

The Wireless Monthly Fee includes a set number of (or in some cases, unlimited) voice minutes and/or text and picture messages a 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 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 PROGRAM, the customer has the right to purchase a new phone at a significant discount (in some cases, for one cent) every 18 months, as long as he remains a PLAN subscriber. Unlike BUSINESS's former practice, a customer enrolled in the 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 PROGRAM are provided through the accrual and redemption of points. A customer earns points as follows: every six months based on the length of time he has been enrolled in the PROGRAM; each month based on the 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 contract and phone

book information with BUSINESS; and for referring other customers. Also, an existing BUSINESS customer who signs up for a PLAN will receive a one-time award of points (although due to inadvertent programming errors some new customers also received these points).

Every month, a customer's bill shows the Wireless Monthly Fee due to BUSINESS, which is not allocated between voice service, text messages, data or points: there is simply one lump-sum charge for the entire contract.<sup>iv</sup> A customer's accrued points can be viewed only on the BUSINESS 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.<sup>v</sup>

Once accrued, a customer can exchange points for a discount on a new phone; a discount on phone accessories (cases, extra batteries, covers, etc.);<sup>vi</sup> 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 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').<sup>vii</sup> Points cannot discount the price of phones or tangible accessories to less than one cent. The only means by which BUSINESS permits a customer to obtain Phone Acceleration is by redeeming points; BUSINESS 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 BUSINESS-owned store, a BUSINESS store owned by an independent agent, or call BUSINESS 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.

The Wireless Monthly Fee is generally subject to Telecommunications Tax. Internet access is nontaxable under the Internet Tax Freedom Act ('Nontaxable Internet Service'), except in a few states that were grandfathered. To that end, the Streamlined Sales Tax Act and the federal Mobile Telecommunications Sourcing Act exclude from tax that portion of the bundled Wireless Monthly Fee allocable to Nontaxable Internet Service. BUSINESS has determined that a portion of the data supplied over its wireless network qualifies as Internet Access. Other than in those grandfathered states, a small portion of the Wireless Monthly Fee is accordingly allocated by BUSINESS each month to Nontaxable Internet Service and is not subject to tax.

BUSINESS encourages its customers to receive and pay their bills online. To do so, BUSINESS has 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.

#### RULINGS REQUESTED

1. Telecommunications Tax is due only on the Taxable Portion of the Wireless Monthly Fee, without decrease for any imputed value of points issued.

2. When points are exchanged for discounted tangible goods, which are never discounted below one cent, taxable digital goods, or taxable services, Sales or Telecommunications Tax (as appropriate) is imposed on the net amount of cash paid by the customer, and no Use Tax is due on the discounted tangible goods.
3. No Sales Tax is due when a customer redeems points for Phone Acceleration or other nontaxable goods and services.
4. Telecommunications Tax is due on the net amount paid when a subscriber receives a discount for automatically paying online and accepting paperless billing.

#### ANALYSIS

1. Telecommunications Tax is due only on the Taxable Portion of the Wireless Monthly Fee, without decrease for any imputed value of points awarded.

The points are identical to coupons issued by a retailer which also honors their redemption and does not receive a reimbursement from a wholesaler or manufacturer (a 'Retailer Coupon'). See Hellerstein, *State Taxation* at 17.06 [1] (discussing the form of customer PROGRAMs). The only difference is that the discount here is provided in the form of intangible points that are tracked and redeemed electronically rather than in the form of paper coupons. Because BUSINESS does not receive reimbursement from any source for the discounts it provides its customers through the PROGRAM, the mere difference in form from a paper retailer coupon is of no significance and should not affect the tax treatment. Our research has revealed no state which reduces the amount of Sales or Telecommunications Tax due on account of a Retailer Coupon issued at the time of sale of taxable goods or services. In each case, Sales or Telecommunications Tax is due on the full amount of the cash paid by the customer.

Indeed, it would be inappropriate to make any such reduction. A coupon is merely a right to a future discount acquired as part of the taxable sale of goods and services and is not a separate nontaxable item for which a separate charge is made. The consistent practice of the states is to charge sales tax on the full price at which taxable goods or services are sold without reduction for any coupons issue, and impose tax on only the net amount of cash received when the coupon is subsequently redeemed for taxable goods or service at a discounted price. See Hellerstein, *State Taxation* at 17.05 & 17.06[1], citing *RIA All State Tax Guide* ¶ 256; see also, Arizona Privilege Tax Ruling 93-33 (May 10, 1995); Illinois Private Letter Ruling ST 93-0482-PLR (September 24, 1993); Kentucky Revenue Cabinet Tax Policy (51P290) (July 1, 1990).

2. When points are exchanged for discounted tangible goods, which are never discounted below one cent, taxable digital goods, or taxable services, Sales or Telecommunications Tax (as appropriate) is imposed on the net amount of cash paid by the customer, and no Use Tax is due on the discounted tangible goods.

The redemption of points for discounted tangible goods (phones and phone accessories) which are never discounted below one cent, or for taxable digital goods (such as ringtones<sup>viii</sup> in some states) or taxable services (such as an Additional Line, Overage Forgiveness, or ringback service), should be treated identically to the redemption of Retailer Coupons, because, as noted in the first ruling request above, the former is merely an example of the latter. That is, the redemption of points is either a

purchase of tangible personal property or digital goods at a discount (in the case of phones, phone accessories and digital goods), or is a discount on the customer's Wireless Monthly Fee that would otherwise be due (in the case of an Additional Line or Overage Forgiveness).

Generally, when a customer redeems a Retailer Coupon for a discount on taxable goods, sales tax is imposed on the discounted price only. See Hellerstein, *State Taxation* at 17.05 & 17.06[1], citing *RIA All States Tax Guide* ¶ 256; see, for example, 86 Ill. Admin Code 130.2125; Iowa Code § 423.1(47)(b)(1); Iowa Admin. Code r. 701-15.6(3); Mo. Code Regs. 10-103.555; 7 N.C. Admin. Code 7B.0122; Wis. Admin. Code 11.28(3). BUSINESS is not reimbursed for the discount given when the points are redeemed—the crucial feature of a Retailer Coupon. Following the correct treatment of Retailer Coupons, Sales Tax or Telecommunications Tax (as appropriate) is due only on the cash paid by the customer.<sup>ix</sup>

Although we have not found any authority directly addressing a program like the PROGRAM, states have considered similar arrangements. Iowa has twice considered rewards programs in which customers earned points for gallons of gas purchased from participating truck stops, and could exchange those points to obtain discounts on future purchases. Iowa concluded both times that only the discounted purchase price was subject to Sales Tax. See *In the Matter of: Iowa 80 Truckstop, Inc.*, Declaratory Order 02-30-6-0262 (concluding that 'only the net amount, if any, after applying the redeemed certificates is the basis for Iowa Sales Tax'); Iowa Letter of Finding (09/28/1995) (concluding that 'the value of any certificate would be excluded from taxable gross receipts'). The requested ruling is consistent with these authorities.

Some states have considered the case of points that can be redeemed for hotel stays, which is generally treated as a taxable service: those rulings conclude that no tax is due upon the redemption of points for hotel stays when the hotel is not reimbursed for the cost of the room by an outside party. See Illinois Letter Ruling 06-0018 (October 18, 2006); Ruling of the Tax Commissioner, PD on 07-12, 2007 WL 1101290, at \*1 (Va. Dep't of Revenue Mar. 23, 2007) (citing Ruling of the Tax Commissioner, PD 04-68, 2004 WL 2271372 (Va. Dep't of Revenue Aug. 24, 2004)). The requested ruling is consistent with these authorities.

Finally, no Use Tax is due on the discounted tangible goods sold in exchange for cash and the redemption of points. As noted, when points are redeemed toward the purchase of phones or accessories, a charge of at least one cent will be made. Although no contract will be required after the first contract, the purpose of the PROGRAM is to incentivize customers to remain loyal customers, and it is expected that the program will successfully reduce BUSINESS's churn (*i.e.*, turnover) rate and actually increase the length of time that customers continue to purchase wireless service from BUSINESS. In other words, this program is intended and expected to have the same or better results as requiring customers to sign a contract.

States when addressing the question of whether Sales or Use Tax is due on discounted taxable goods have strictly adhered to statutory language that imposes Sales Tax on gross receipts, and found that there is a taxable sale for the discounted amount and that no donation or taxable other use of the discounted property is made by the seller. See, for example, Illinois Dept. of Rev. General Information Letter ST 97-0275-GIL (May 21, 1997) ('tax is measured by the sellers' gross receipts from sales of tangible personal property'); Iowa Letter of Finding (01/05/1995) ('the gross receipts would be the actual

selling price of the cellular equipment’); Missouri Private Letter Ruling No. LR 3758 (April 18, 2007) (sales tax should be charged ‘on the actual amount for which a cellular telephone is sold, even if such amount is less than the carrier’s total cost of the telephone’).

3. No Sales Tax is due when a customer redeems points for Phone Acceleration or other nontaxable digital goods and services.

Phone Acceleration is an intangible right to buy wireless phones at a discount at a time earlier than could otherwise be done. In other words, points are redeemed for Phone Acceleration only to move up the time at which a phone can be purchased at a discount. Phone acceleration is not itself a discount, and cannot be obtained except through the redemption of points. Additional points must be redeemed to purchase the phone itself at a discount (see above). The purchase of such an intangible right is generally not subject to Sales Tax and thus the redemption of points to purchase such a right should likewise not be subject to tax.

Similarly, a redemption of points for nontaxable digital goods or services (such as ringtones in certain states), should not become taxable simply because points are used as the medium of exchange.

4. Telecommunications Tax is due on the net amount paid when a subscriber receives a discount for paying online.

The three or five percent discount for automatic online bill payment and paperless bills should be treated in the same manner as any other retailer discount, pursuant to which the customer pays tax on the net amount of cash paid. We have not found any specific authority on discounts given for online payment. There is guidance, however, in a closely related area. States generally treat discounts given to encourage prompt payment after the completion of a sale the same as a Retailer Coupon, and charge tax only on the net amount paid. See 86 Ill. Adm. Code 130.420; Illinois Private Letter Ruling ST 91-0822-PLR (October 28, 1991); Illinois Private Letter Ruling ST 91-0167-PLR (March 6, 1991); Illinois Private Letter Ruling ST 90-0609-PLR (September 18, 1990); Iowa Admin. Code §701-212.3(1); Mo. Rev. Stat. §144.605(8); N.C. Admin. Code 17 §7B.0108(b); Wis. Stat. §77.51(15b)(b)(1); Wis. Admin. Code Tax § 11.32. The online payment discount is merely another example of a discount for a preferred payment method, and should accordingly be taxed the same. Indeed, the case for not taxing the online payment discount is even stronger than the case for not taxing a prompt payment discount, because the online payment method and discount is agreed to and acknowledged by both parties prior to the provision of the monthly wireless service.

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Thank you for your consideration of this request. Please do not hesitate to call me if you have any questions, or would like any additional information. We respectfully request a conference in the event the Department tentatively concludes an adverse ruling would be warranted. A power of attorney authorizing the undersigned to represent BUSINESS in this matter is attached. This ruling request pertains only to periods beginning October 1, 2010, and none of BUSINESS or any of its affiliates operating in your state is under audit for such periods.

## DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). The Department declines to issue a Private Letter Ruling. Although we are not providing you with a Private Letter Ruling, we hope the following general information regarding discounts will be of assistance.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling tangible personal property at retail. The State tax rate is 6.25% of gross receipts for most items, and a lower rate of 1% for qualifying food, drugs and medical appliances. 35 ILCS 120/1 *et seq.* Local occupation taxes may also be applicable.

Gross receipts subject to Retailers' Occupation Tax are defined as all the consideration actually received by the seller. If a seller provides a discount to a purchaser and does not receive a reimbursement or rebate from any source for that discount, only the (discounted) amount received by the seller is taxable. For example, if a retailer sells an item for \$10 and the purchaser provides the retailer with a \$1 in-store coupon for which the retailer receives no reimbursement from the manufacturer of the item or any other source, the retailer's gross receipts of \$9 are subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(1).

When a retailer receives full or partial coupon reimbursement (from a manufacturer, distributor or any other source), the retailer incurs Retailers' Occupation Tax liability on the receipts received from the purchaser and the amount of any coupon reimbursement. For example, if a retailer lists an item for sale for \$15 and the purchaser provides the retailer with a \$5 manufacturer's coupon for which the retailer receives full reimbursement from the manufacturer of the item, the retailer's gross receipts are the \$10 received from the customer and the \$5 received from the manufacturer for a total of \$15 that is subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(2).

When a retailer issues a coupon to a purchaser which entitles the purchaser to a free item conditioned on the purchase of a separate item (two-for-one, buy one get one free, etc.), the retailer's gross receipts are measured only by the amount actually received from the purchaser for both items. Thus, tax is only incurred on the amount actually received from the purchaser. The retailer does not incur tax based upon the value of the free item received because technically the item was not free and no gift was intended. The retailer was simply offering a special price for both items sold.

The Illinois Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons. 35 ILCS 630/3 and 4. The Simplified Municipal Telecommunications Tax Act allows municipalities to impose a tax on the act or privilege of originating in such municipality or receiving in such municipality intrastate or interstate telecommunications by persons in Illinois at a rate not to exceed 6% for municipalities with a population of less than 500,000, and at a rate not to exceed 7% for municipalities with a population of 500,000 or more, of the gross charges for such telecommunications purchased at retail from retailers by such persons. 35 ILCS 636/5-10 and 5-15.

"Gross charges" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money whether paid in money or otherwise, including cash, credits, services

and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service costs or any other expense whatsoever. "Gross charges" do not include charges for the storage of data or information for subsequent retrieval or the processing of data or information intended to charge its form or content. "Gross charges" also do not include charges for customer equipment, including such equipment that is leased or rented by the customer from any source, wherein such charges are disaggregated and separately identified from other charges in the books and records of the retailer. See 35 ILCS 630/2.

Generally, the treatment of discounts under the Telecommunications Excise Tax Act is similar to the treatment of discounts under the Retailers' Occupation Tax Act described above. If a telecommunications company does not receive any reimbursement from any source for the discounts provided to its customers, that company generally would not include the redemption of a discount as a part of gross charges in determining its Telecommunications Excise Tax liability.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters  
Associate Counsel

RSW:mks

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<sup>i</sup> Please note that BUSINESS is submitting concurrently herewith a separate ruling request with respect to the taxation of a phone replacement program. The phone replacement program is available only with respect to certain premium plans, not all plans for which the PROGRAM is offered. The two programs otherwise operate independently of one another and thus separate rulings are being requested.

<sup>ii</sup> As noted below, this allocation is made solely for accounting purposes; the points have no cash value and may never be redeemed for cash.

<sup>iii</sup> More information about the PLANS can be found at WEB ADDRESS.

<sup>iv</sup> Although a bill would show a separate line item for minutes, texts or data consumed that were not part of a customer's plan.

<sup>v</sup> BUSINESS, for accounting purposes only, assigns a value to the points as they are accrued, which is adjusted over time to reflect the value of awards offered. *For financial accounting, but not Sales, Use or Telecommunications Tax purposes*, at the time BUSINESS accrues monthly service fee revenue, it defers an amount equal to the accounting value of points awarded, and later recognizes the accounting value of the points as revenue when they are redeemed. Again, the points can never be redeemed for cash.

<sup>vi</sup> Accessories are shipped to the customer via mail from BUSINESS's third-party fulfillment center in STATE, even when points are redeemed at a BUSINESS or independently owned stores.

<sup>vii</sup> An example will make the acceleration option more clear. A customer who received a new phone 15 months ago would have to wait three more months for the right to buy a new phone at a discount. If the customer wanted a new phone that BUSINESS just began offering without paying the full price, the customer would have the option of exchanging a certain number of points for the right to buy the new phone at a discount immediately, without waiting the remaining three months. The customer would then receive whatever discount BUSINESS was offering on the chosen phone at that time.

<sup>viii</sup> BUSINESS understands that, when it gives away taxable digital goods such as ringtones, it may be subject to a use tax on its cost of the taxable digital goods that it acquired to give away.

<sup>ix</sup> Illinois Private Letter Ruling ST 98-0004-PLR (July 7, 1998) is not to the contrary. In that ruling, the Department held that when a cable subscriber exchanged accrued points for free merchandise, use tax was due on the cost of the free merchandise. This ruling does not address the facts in this Letter, because no taxable goods will be provided to the customer for free.