New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-86(41)S
Sales Tax
October 20, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. S860528A

On May 28, 1986, a Petition for Advisory Opinion was received from Peat, Marwick, Mitchell Co., 74 North Pearl Street, Albany, New York 12207.

The issue raised is whether a bank or its depositors are liable for sales tax on certain promotional items.

Petitioner describes the bank's transactions as follows:

A commercial bank is contemplating a promotional "gift" program. Under such program, depositors investing in certificates of deposit will receive a gift shortly after depositing funds. The gifts will be chosen by the depositor from various distinct categories. Within each category, all the gifts will be of relatively equal monetary value. The categories will consist of a range of gift values, e.g. gifts in the lowest value category will be of relatively less value than gifts in the highest category. The category of gifts from which the depositor might choose will be dependent upon both the dollar value of the certificate of deposit and the maturity date of the deposit. For purposes of example only, deposits of $1,000 with a maturity of three years (here presumed to be the lowest dollar amount and shortest maturity period) would receive gifts from the lowest monetary value category while deposits of $100,000 with a maturity of seven years (here presumed to be the highest dollar amount and longest maturity period) would receive gifts from the highest monetary value category. Deposits between those dollar amounts and maturity dates would receive gifts from categories falling between the highest and lowest.

All of the gifts are tangible personal property. Further, none of the gifts under this program are considered to be nominal in value.

In determining the yield to depositors on such certificates of deposits, the bank will look at two elements. First, the value of the gifts (i.e., the bank's purchase price) will be factored into the yield calculation. Second, the actual cash interest earned on the certificate will be added to the value of the gift. These two elements, in combination, will represent the overall yield on the instrument. The bank will adjust its interest rate offered on the certificate so that the overall yield will be competitive in its geographic area.

For purposes of Federal income tax (and therefore for the Article 32 NYS Franchise Tax) the value of the gifts will be treated as prepaid interest under Internal Revenue Code 461(g). As such, the purchase price of the gift will not be deductible in full in the year in which it is transferred to the depositor. Rather, the cost of the gift will be capitalized and amortized over the life of the deposit and treated as interest expense. It is contemplated that should the depositor cash-in the certificate of deposit before its maturity date, that depositor will forfeit accrued but unpaid interest and possibly principal (if accrued but unpaid interest is insufficient) for the applicable prorated portion of the

bank's cost of the gift. This pro rata portion would decrease over the life of the certificate.

The proposed program will be administered with the assistance of an unrelated, third-party vendor. The vendor will provide certain necessary support services relative to the administration of the program including supplying the gifts, shipping gifts to the depositors, etc. In exchange for services and product received the bank will pay to the vendor a price closely approximating the retail value of the items. There is not expected to be any discount available to the bank.

Petitioner asserts that the bank should be considered the retail purchaser of the gift items. In support of its assertion, Petitioner relies on Sales Tax Regulation 526.6(c)(4)(i) and Example 2 of such regulation. In the alternative, Petitioner contends that the "gifts" lose their classification as tangible personal property upon transfer to the depositor since the "gift" is interest income to the depositor and interest expense to the bank.

Law and Regulations

Section 526.6(c)(4) of the regulations of the State Tax Commission provides:

(i) Tangible personal property which is purchased and given away without charge, for promotion or advertising purposes is not purchased for resale. It is a retail sale to the purchaser thereof, and is not a sale to the recipient of the property.

(ii) Tangible personal property which is purchased for promotional or advertising purposes and sold for a minimal charge which does not reflect its true cost, or which is not ordinarily sold by that person in the operation of his business, is a retail sale to the purchaser thereof, and not a sale to the recipient of the property.

(iii) A resale certificate may not be used by the person making the purchases described in subparagraphs (i) and (ii) of this paragraph for such purchases:

Example 2: A bank has purchased premiums which will be given to depositors upon the opening of an account in a new branch. As the bank is not in the business of selling such items, and as it in fact does not sell such items to its customers, the sale to the bank of such items of tangible personal property is a retail sale which is taxable at the time of purchase. The bank has not purchased these items for resale. 20 NYCRR 526.6.

Section 1101(b)(5) of the Tax Law provides:

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume, conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

Section 526.7(b) of the regulations of the State Tax Commission provides:

(b) Consideration. The term consideration includes monetary consideration, exchange, barter, the rendering of any service, or any agreement therefor. Monetary consideration includes assumption of liabilities, fees, rentals, royalties or any other charge that a purchaser, lessee or licensee is required to pay. 20 NYCRR 526.7.

Conclusions

Regulation section 526.6(c)(4) is intended to show the effect of the Tax Law upon transactions where either no consideration is given or a minimal amount of consideration (not reflective of the value of the item) is given in return for a specified item. Such is not the case here. Petitioner states that "[n]one of the gifts under this program are considered nominal in value"; "the value of the gifts will be factored into the yield calculation," and "the value of the gift, will be added to the actual cash interest earned on the certificate". Petitioner also indicates that the value of the gifts have a relationship to the amount deposited and its maturity value.

Petitioner's reliance on regulation 526.6(c)(4) and Example 2 of that regulation is misplaced. Example 2 does not address the situations where interest is forgiven in an amount approximately equal to the value of the gift. Rather, the example addresses the simple situation where a gift is given without consideration (other than the opening of the bank account) and there is no reduction in the amount of interest that a depositor earns.

Petitioner states that all gifts are tangible personal property. The fact that the depositor will accept a reduced amount of interest in exchange for a gift cannot change the character of tangible personal property to that of an intangible.

Accordingly, the transfer of a "gift" in exchange for the forbearance of interest is a sale within the meaning and intent of 1101(b)(5) of the Tax Law and is subject to sales and use tax. The amount subject to tax is the actual amount of interest given in exchange for the "gift". It should be noted that

the bank may purchase the "gifts" without payment of sales tax by providing to its supplier a properly completed resale certificate (form ST-120). However, the bank must collect sales and use tax upon transferring the "gifts" to its customers.

DATED: October 20, 1986

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.