

Excise Tax Advisory

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The Taxability of Unredeemed Gift Cards

Purpose

In general, taxes are due on gift cards and gift certificates (collectively, “gift cards”) when redeemed by the card’s owner. In some instances, gift cards sold by an issuer are never redeemed. This Excise Tax Advisory (ETA) addresses the taxability of unredeemed gift cards to the issuer of the card.

This ETA does not address the taxability of prepaid phone cards or debit cards, nor does it explain the tax consequences of third party entities that sell gift cards on behalf of the issuer.

Accounting for abandoned gift cards

Pursuant to RCW 19.240.020, most gift cards purchased or used in Washington do not expire. Under RCW 63.29.140(1) of the Uniform Unclaimed Property Act, gift cards are presumed abandoned if unredeemed after three years. However, per RCW 63.29.140(3), businesses issuing gift cards that are presumed abandoned do not have to report the abandoned gift cards as unclaimed property.

A business selling gift cards has several options to account for the gift cards once they become abandoned:

- The business may continue to carry unredeemed cards on their financial books and records indefinitely as a liability; or
- The business may elect to treat the abandoned cards as income. When recognizing this as revenue for tax and accounting purposes, it is referred to as “breakage income”; or
- The business could, but is not required to, report the abandoned gift cards to the Department as unclaimed property.

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Regardless of how the issuer accounts for an abandoned gift card, the owner of the card may still redeem it at any time, even after it is presumed abandoned.

Taxability of unredeemed gift cards

In general, when gift cards are redeemed for tangible personal property or retail services, the issuer is subject to the retailing business and occupation (B&O) tax and must collect retail sales tax at the time of the sale.

In many instances, however, the owner of the gift card never redeems the card because it has been lost or destroyed. In such a case, the issuer has no retailing B&O or retail sales tax liabilities.

Nonetheless, if the issuer of the abandoned gift card elects to recognize it as breakage income for federal tax reporting and accounting purposes, the issuer must likewise report the income under the service and other activities B&O tax classification on its excise tax return when the income is recognized. Generally, breakage income is apportioned under WAC 458-20-19402(303) *Single factor receipts apportionment – Generally*.

If the abandoned gift card is later redeemed by the card's owner, the issuer may claim a deduction within the nonclaim period in RCW 82.32.060 for the income previously reported under the service and other activities B&O tax classification.

Examples

For each of the following examples, the issuer of the gift card is the same as the retail business where the card is redeemed.

- A. In 2013, Susan purchases a \$50 gift card as a birthday present for her brother, Joe. Joe forgets about the card for a couple of years, but remembers and uses the card when making a retail purchase in 2015. The issuer must report the retailing B&O and retail sales tax at the time of sale.
- B. Assume the same facts as in Example A above, except that it is now 2016, three years after Joe's gift card was purchased, and the 2015 sale never occurred. At this point, the card is presumed abandoned by the issuer, even though Joe may still use the card at any future date. The card's issuer has three options: (1) it can continue to list the \$50 value of the card as a liability on its books and records indefinitely; (2) it can, but is not required to, report the gift card to the Department as abandoned property; or (3) it can recognize the unused gift card as income. If the issuer chooses to recognize the unredeemed gift card as income, it must also report the \$50 of income in 2016 under the service and other activities B&O classification for excise tax purposes.
- C. Assume the same facts as in Example B. In 2017, Joe discovers and uses his gift card to make a retail purchase. The issuer must report the retail sale under the retailing B&O and retail sales tax classifications at the time of sale in 2017. To

account for the service and other activities B&O tax it paid in 2016 on its
breakage income, the issuer may take a deduction against its tax liability in 2017.

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