

201608950L

To: Denise Stewart, Audit Division

From: Teresa Bostick, Tax Policy Division

Date: August 11, 2016

RE: Vendor Funded Incentives (VFI) for Franchise Tax

Vendors provide various types of allowances, credits, and rebates to retailers through a variety of programs and arrangements to support the merchandise purchased for resale. These funds are collectively referred to as Vendor Funded Incentives (VFI) and include things like volume-based purchase price adjustments, sales-based incentives, product placement incentives, new store allowances, and depletion allowances.

The Texas statutes and rules do not specifically address treatment of VFI for franchise tax purposes. However, the computation of COGS under Tex. Tax Code Section 171.1012 specifically excludes from COGS selling costs and advertising costs. Tex. Tax Code Section 171.1012(e)(2) and (4).

Some retailers contend that VFI should not be reported as a reduction (contra-expense) to the franchise tax COGS computation because VFI relate to the sale of goods (i.e., selling costs) rather than the purchase of goods for resale. This memo clarifies how to treat various types of VFI for Texas franchise tax purposes.

Description of VFI programs:

- * Advertising – Vendor payments for costs incurred in publishing an advertisement.
- * Coupon Program-Face Value – Vendor payments for the face value of coupons that are used to reduce the selling price to the customer.
- * Coupon Program-Handling Fee – Vendor payments for handling costs incurred in producing a coupon.
- * Depletion Allowance/Volume Incentives – Vendor payments received once a sales goal is reached.
- * Mark Down Funding – Vendor payments received as part of an exit strategy (i.e. phase out) of a product that are used to reduce the selling price to the customer.
- * New Item Allowances – Vendor payments for costs incurred in getting a new item to the shelf.
- * Product Demos – Vendor payments for costs incurred in putting on a product demo.
- * Product Placement – Vendor payments for strategic placement of goods.
- * Sales based incentives – Vendor payments received based on a reduction in the selling price to the customer.
- * Shows/Seminars – Vendor payment for costs incurred in putting on a product show/seminar.

* Temporary Price Reductions – Vendor payments received as part of a short-term promotion that are used to reduce the selling price to the customer.

Comptroller's Position:

The following VFIs relate to advertising or selling activities and the contra-expense accounts are excluded from the COGS calculation.

- * Advertising
- * Coupon Program-Handling fees
- * Product Demos
- * Product Placement
- * Shows/Seminars

The following VFIs are considered sales-based incentives and if not reported as revenue, are included in the COGS calculation as a contra-expense.

- * Coupon Program-Face Value
- * Depletion Allowance/Volume Incentives
- * Mark Down Funding
- * New Item Allowances
- * Sales Based Incentives
- * Temporary Price Reductions

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