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U.S. Tax Court: Credit card “reward dollars” held taxable income

The U.S. Tax Court issued an opinion finding that credit card “reward dollars” were taxable income to the taxpayers, who had used a series of transactions to generate and then monetize the reward dollars.

The case is: *Anikeev v. Commissioner*, T.C. Memo 2021-23 (February 23, 2021). Read the Tax Court’s [opinion](#) [PDF 87 KB]

Background

The taxpayers (a married couple) during 2013 and 2014 received “reward dollars” from a credit card company when they made purchases using the card. The reward dollars were based on a percentage of the dollar amount of the card user’s eligible purchases (that is, purchases made with the card for goods and services minus returns and other credits). Above a threshold amount (\$6,500), the reward dollars were equal to 5% of “everyday purchases” at grocery stores, gas stations, and drugstores and 1% of all other eligible purchases.

The reward dollars earned during a billing period became available for redemption after the subsequent billing period if the card was in good standing. The credit card company treated all of the taxpayers’ purchases in 2013 and 2014 as qualifying for reward dollars.

To generate as many reward dollars as possible, the taxpayers used their credit cards to purchase gift cards (prepaid cards) of another credit card company at grocery stores and drugstores, and then they used these gift cards to purchase money orders which they then deposited into their bank accounts.

In 2013, the taxpayers charged over \$1.2 million on the credit card, of which over 99% of the transactions were for gift cards, reloadable debit cards, and money orders. The taxpayers redeemed \$36,200 in reward dollars as credit card statement credits in 2013.

In 2014, the taxpayers’ credit card charges were over \$5.18 million for gift cards, reloadable debit cards, and money orders. The taxpayers redeemed over \$277,000 in reward dollars as statement credits in 2014.

The taxpayers did not report the reward dollars as income on their income tax returns for 2013 and 2014.

The IRS determined that the reward dollars were income and issued notices of deficiency for 2013 and 2014.

Tax Court opinion

The Tax Court upheld the deficiency determinations and the inclusion in income of the reward dollars. The court noted that the “aggressive efforts” of the taxpayers to generate reward dollars created a dilemma for the IRS “largely the result of the vagueness of IRS credit card reward policy.” As the court found, the taxpayers clearly acquired economic benefits “by cleverly and relentlessly manipulating” the rewards program and their success in acquiring rewards “makes this case an extreme test of the longstanding nontaxability of credit card reward programs.”

The court examined the rebate rule, as set forth in Rev. Rul. 76-96 (ruling that a purchase incentive such as credit card rewards or points is not treated as income but as a reduction of the purchase price of what is purchased with the rewards or points). Also, the court found the reward dollars were distinguishable from the noncash awards or “thank you points” earned in connection with maintaining a bank account.

Rather, the Tax Court found that the money orders ultimately purchased with funds generated from the taxpayers’ use of the credit card and the infusion of cash into the reloadable debit cards were “difficult to reconcile” with the IRS credit card reward policy. No product or service was obtained with these uses of the credit card—other than cash transfers. The money orders were not properly treated as a product subject to a price adjustment because they were eligible for deposit into the taxpayers’ bank account from acquisition. Similarly, the cash infusions to the reloadable debit cards were not product purchases.

The Tax Court concluded that the holding in this case was based on the “the incompatibility of the direct money order purchases and the debit card reloads with the IRS policy excluding credit card rewards for product and service purchases from income ... [and] on the unique circumstances of this case.” The court concluded: “We hope that respondent polices the IRS policy in the future in regulations or public pronouncements rather than relying on piecemeal litigation.”

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