

excess discount is includible in the employee's income. For example, if the discount on employer-purchased property is 30 percent and the employer's gross profit percentage for the period in the relevant line of business is 25 percent, then 5 percent of the price at which the property is being offered for sale to customers is includible in the employee's income. With respect to services, an employee discount of up to 20 percent may be excludable. If an employee discount exceeds 20 percent, the excess discount is includible in the employee's income. For example, assume that a commercial airline provides a pass to each of its employees permitting the employees to obtain a free round-trip coach ticket with a confirmed seat to any destination the airline services. Neither the exclusion of section 132(a)(1) (relating to no-additional-cost services) nor any other statutory exclusion applies to a flight taken primarily for personal purposes by an employee under this program. However, an employee discount of up to 20 percent may be excluded as a qualified employee discount. Thus, if the price charged to customers for the flight taken is \$300 (under restrictions comparable to those actually placed on travel associated with the employee airline ticket), \$60 is excludible from gross income as a qualified employee discount and \$240 is includible in gross income.

[T.D. 8256, 54 FR 28603, July 6, 1989]

§ 1.132-3T Qualified employee discount—1985 through 1988 (temporary).

(a) *In general*—(1) *Definition*. Gross income does not include the value of a qualified employee discount. The term "qualified employee discount" means any employee discount with respect to qualified property or services provided by an employer to an employee for the employee's personal use to the extent the discount does not exceed—

(i) The gross profit percentage of the price at which the property is offered to customers, for discounts on property, or

(ii) 20 percent of the price at which the services are offered to customers, for discounts on services.

(2) *Qualified property or services*—(i) *In general*. The term "qualified property or services" means any property or services that are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee performs substantial services. For rules relating to the line of business limitation, see § 1.132-4T.

(ii) *Exception for certain property*. The term "qualified property" does not include real property and it does not include personal property (whether tangible or intangible) of a kind commonly held for investment. Thus, an employee may not exclude from gross income the amount of an employee discount provided on the purchase of either residential or commercial real estate, securities, commodities, or currency, whether or not the particular purchase is made for investment purposes.

(iii) *Property and services not offered in ordinary course of business*. The term "qualified property or services" does not include any property or services of a kind that is not offered for sale to customers in the ordinary course of the line of business of the employer. For example, employee discounts provided on property or services that are offered for sale only to employees and their families (such as merchandise sold at an employee store or through an employer-provided catalog service) may not be excluded from gross income.

(3) *No reciprocal agreement exception*. The exclusion for a qualified employee discount does not apply to property or services provided by another employer pursuant to a written reciprocal agreement that exists between employers to provide discounts on property and services to employees of the other employer.

(4) *Cash or third-party rebates*—(i) *Property or services provided without charge or at a reduced price*. The exclusion for a qualified employee discount applies whether the property or service is provided at no charge (in which case only part of the discount may be excludable as a qualified employee discount) or at a reduced price. The exclusion also applies if the benefit is provided through a partial or total cash

rebate of an amount paid for the property or service.

(ii) *Property or services provided directly by the employer or indirectly through a third party.* A qualified employee discount may be provided either directly by the employer or indirectly through a third party. For example, an employee of an appliance manufacturer may receive a qualified employee discount on the manufacturer's appliances purchased at a retail store that offers such appliances for sale to customers. The employee may exclude the amount of the qualified employee discount whether the employee is provided the appliance at no charge or purchases it at a reduced price, or whether the employee receives a partial or total cash rebate from either the employer-manufacturer or the retailer. If an employee receives additional rights associated with the property that are not provided by the employee's employer to customers in the ordinary course of the line of business in which the employee performs substantial services (such as the right to return or exchange the property or special warranty rights), the employee may only receive a qualified employee discount with respect to the property and not the additional rights. Receipt of such additional rights may occur, for example, when an employee of a manufacturer purchases property manufactured by the employee's employer at a retail outlet.

(5) *Applicability of nondiscrimination rules.* The exclusion for a qualified employee discount applies to officers, owners, and highly compensated employees only if the discount is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer that does not discriminate in favor of officers, owners, or highly compensated employees. See § 1.132-8T.

(b) *Employee discount—(1) Definition.* The term "employee discount" means the excess of—

(i) The price at which the property or service is being offered by the employer for sale to customers, over

(ii) The price at which the property or service is provided by the employer to an employee for use by the employee.

A transfer of property by an employee without consideration is considered use by the employee for purposes of this section. Thus, for example, if an employee receives a discount on property offered for sale by his employer to customers and the employee makes a gift of the property to his parent, the property will be considered to be provided for use by the employee, thus enabling the discount to be eligible for exclusion as a qualified employee discount.

(2) *Price to customers—(i) Determined at time of sale.* In determining the amount of an employee discount, the price at which the property or service is being offered to customers at the time of the employee's purchase is controlling. For example, assume that an employer offers a product to customers for \$20 during the first six months of a calendar year, but at the time the employee purchases the product at a discount, the price at which the product is being offered to customers is \$25. In this case, the price from which the employee discount is measured is \$25.

(ii) *Quantity discount not reflected.* The price referred to in paragraph (b)(2)(i) of this section cannot reflect any quantity discount unless the employee actually purchases the requisite quantity of the property or service.

(iii) *Customers of employee's employer controls.* In determining the amount of an employee discount, the price at which the property or service is offered to customers of the employee's employer is controlling. Thus, the price at which property is sold to the wholesale customers of a manufacturer will generally be lower than the price at which the same property is sold to the customers of a retailer. However, see paragraph (a)(4)(ii) of this section regarding the effect of a wholesaler providing to its employees additional rights not provided to customers of the wholesaler in the ordinary course of its business.

(iv) *Discounts to discrete customer or consumer groups.* In determining the amount of an employee discount, if an employer offers for sale property or services at one or more discounted prices to discrete customer or consumer groups, and sales at all such discounted prices comprise at least 35 percent of the employer's gross sales for a

representative period, then the price at which property or service is being offered to customers is a discounted price. The applicable discounted price is the current undiscounted price, reduced by the percentage discount at which the greatest percentage of the employer's gross sales are made for such representative period. If sales at different percentage discounts equal the same percentage of the employer's gross sales, the price at which the property or service is being provided to customers may be reduced by the average of the two group discounts. For purposes of this section, a representative period is the taxable year of the employer immediately preceding the taxable year in which the property or service is provided to the employee at a discount. If more than one employer would be aggregated under section 414 (b), (c), or (m), and all of the employers do not have the same taxable year, the employers required to be aggregated must designate the 12-month period to be used in determining gross sales for a representative period.

(v) *Examples.* The rules provided in this paragraph (b)(2) are illustrated by the following examples:

Example (1). Assume that a wholesale employer offers property for sale to two discrete customer groups at differing prices. Assume further that during the prior taxable year of the employer, 70 percent of the employer's gross sales are made at a 15-percent discount and 30 percent at no discount. The current undiscounted price at which the property or service is being offered by the employer for sale to customers may be reduced by the 15-percent discount.

Example (2). Assume that a retail employer offers a 20 percent discount to members of the American Bar Association, a 15 percent discount to members of the American Medical Association, and a ten percent discount to employees of the Federal Government. Assume further that during the prior taxable year of the employer, sales to American Bar Association members equal 15 percent of the employer's gross sales, sales to American Medical Association members equal 20 percent of the employer's gross sales, and sales to Federal Government employees equal 25 percent of the employer's gross sales. The current undiscounted price at which the property or service is being offered by the employer for sale to customers may be reduced by the ten percent Federal Government discount.

(3) *Damaged, distressed, or returned goods.* If an employee pays at least fair market value for damaged, distressed, or returned property, such employee will not have income attributable to such purchase.

(c) *Gross profit percentage*—(1) *In general*—(i) *General rule.* An exclusion from gross income for an employee discount on qualified property is limited to the price at which the property is being offered to customers in the ordinary course of the employer's line of business, multiplied by the employer's gross profit percentage. The term "gross profit percentage" means the excess of the aggregate sales price of the property sold by the employer to customers (including employees) over the employer's aggregate cost of the property, then divided by the aggregate sales price.

(ii) *Calculation of gross profit percentage.* The gross profit percentage must be calculated separately for each line of business based on the aggregate sales price and aggregate cost of property in that line of business for a representative period. For purposes of this section, a representative period is the taxable year of the employer immediately preceding the taxable year in which the discount is available. For example, if the aggregate sales of property in an employer's line of business for the prior taxable year were \$800,000, and the aggregate cost of the property for the year were \$600,000, the gross profit percentage would be 25 percent (\$800,000 minus \$600,000, then divided by \$800,000). If more than one employer would be aggregated under section 414 (b), (c), or (m), and all of the employers do not have the same taxable year, the employers required to be aggregated must designate the 12-month period to be used in determining the gross profit percentage. If an employee performs substantial services in more than one line of business, the gross profit percentage of the line of business in which the property is sold determines the amount of the excludable employee discount.

(iii) *Special rule for employers in their first year of existence.* An employer in its first year of existence may estimate the gross profit percentage of a line of business based on its mark-up from the

cost. Alternatively, an employer in its first year of existence may determine the gross profit percentage by reference to an appropriate industry average.

(iv) *Redetermination of gross profit percentage.* If substantial changes in an employer's business indicate at any time that it is inappropriate for the prior years' gross profit percentage to be used for the current year, the employer must, within a reasonable period, redetermine the gross profit percentage for the remaining portion of the current year as if such portion of the year were the first year of the employer's existence.

(2) *Line of business.* In general, an employer must determine the gross profit percentage on the basis of all property offered to customers (including employees) in each separate line of business. An employer may instead select a classification of property that is narrower than the applicable line of business. However, such classification must be reasonable. For example, if an employer computes gross profit percentage according to the department in which products are sold, such classification is reasonable. Similarly, it is reasonable to compute gross profit percentage on the basis of the type of merchandise sold (such as high mark-up and low mark-up classifications). It is not reasonable, however, for an employer to classify certain low mark-up products preferred by certain employees (such as officers, owners, and highly compensated employees) with high mark-up products or to classify certain high mark-up products preferred by other employees with low mark-up products.

(3) *Generally accepted accounting principles.* In general, the aggregate sales price of property must be determined in accordance with generally accepted accounting principles. An employer must compute the aggregate cost of property in the same manner in which it is computed for the employer's Federal income tax liability, pursuant to the inventory rules in section 471 and the regulations thereunder.

(d) *Treatment of leased sections of department stores—(1) In general—(i) General rule.* For purposes of determining whether employees of a leased section

of a department store may receive qualified employees discounts at the department store and whether employees of the department store may receive qualified employee discounts at the leased section of the department store, the leased section is treated as part of the line of business of the person operating the department store, and employees of the leased section are treated as employees of the person operating the department store as well as employees of their employer. The term "leased section of a department store" means a section of a department store where substantially all of the gross receipts of the leased section are over-the-counter sales of property made under a lease, license, or similar arrangement where it appears to the general public that individuals making such sales are employed by the department store. An example of a leased section of a department store is a cosmetics firm that leases floor space from a department store.

(ii) *Calculation of gross profit percentage.* When calculating the gross profit percentage of property and services sold at the department store under paragraph (c) of this section, sales of property and services sold at the department store, as well as sales of property and services sold at the leased section, are considered. The rule provided in the preceding sentence does not apply, however, if it is reasonable to calculate the gross profit percentage for the department store and leased section separately, or if it would be inappropriate to combine them (such as where either the department store or the leased section, but not both, provides employee discounts).

(2) *Employees of the leased section—(i) Definition.* For purposes of this paragraph (d), "employees of the leased section" means all employees who perform substantial services at the leased section regardless of whether the employees engage in over-the-counter sales of property or services. The term "employee" has the same meaning as in section 133(f).

(ii) *Discounts offered to either department store employees or employees of the leased section.* If the requirements of

this paragraph (d) are satisfied, employees of the leased section may receive qualified employee discounts at the department store regardless of whether employees of the department store are offered discounts at the leased section. Similarly, regardless of whether employees of the leased section are offered discounts at the department store, employees of the department store may receive qualified employee discounts at the leased section.

(e) *Excess discounts.* Unless excludable under a statutory provision other than section 132(a)(2), an employee discount provided on property is excludable to the extent of the gross profit percentage multiplied by the price at which the property is being offered for sale to customers. If an employee discount exceeds the gross profit percentage, the excess discount is includible in the employee's income. For example, if the discount on property is 30 percent and the employer's gross profit percentage for the period in the relevant line of business is 25 percent, then 5 percent of the price at which the property is being offered for sale to customers is includible in the employee's income. With respect to services, an employee discount of up to 20 percent may be excludable. If an employee discount exceeds 20 percent, the excess discount is includible in the employee's income.

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§ 1.132-4 Line of business limitation.

(a) *In general*—(1) *Applicability*—(i) *General rule.* A no-additional-cost service or a qualified employee discount provided to an employee is only available with respect to property or services that are offered for sale to customers in the ordinary course of the same line of business in which the employee receiving the property or service performs substantial services. Thus, an employee who does not perform substantial services in a particular line of business of the employer may not exclude from income under section 132 (a)(1) or (a)(2) the value of services or employee discounts received on property or services in that line of business. For rules that relax the line of business

requirement, see paragraphs (b) through (g) of this section.

(ii) *Property and services sold to employees rather than customers.* Because the property or services must be offered for sale to customers in the ordinary course of the same line of business in which the employee performs substantial services, the line of business limitation is not satisfied if the employer's products or services are sold primarily to employees of the employer, rather than to customers. Thus, for example, an employer in the banking line of business is not considered in the variety store line of business if the employer establishes an employee store that offers variety store items for sale to the employer's employees. See § 1.132-7 for rules relating to employer-operated eating facilities, and see § 1.132-1(e) for rules relating to employer-operated on-premises athletic facilities.

(iii) *Performance of substantial services in more than one line of business.* An employee who performs services in more than one of the employer's lines of business may only exclude no-additional-cost services and qualified employee discounts in the lines of business in which the employee performs substantial services.

(iv) *Performance of services that directly benefit more than one line of business*—(A) *In general.* An employee who performs substantial services that directly benefit more than one line of business of an employer is treated as performing substantial services in all such line of business. For example, an employee who maintains accounting records for an employer's three lines of business may receive qualified employee discounts in all three lines of business. Similarly, if an employee of a minor line of business of an employer that is significantly interrelated with a major line of business of the employer performs substantial services that directly benefit both the major and the minor lines of business, the employee is treated as performing substantial services for both the major and the minor lines of business.

(B) *Examples.* The rules provided in this paragraph (a)(1)(iv) are illustrated by the following examples: