Excise Tax Advisory

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Grocery Stores: Manufacturer/Distributor Discounts and Scan-Down Allowances

Purpose

This Excise Tax Advisory (ETA) explains the taxability of grocer incentives and scan-down allowances[1] received by grocers from food manufacturers or distributors. The ETA provides guidance in determining whether a particular incentive or scan-down allowance received by a retail grocer is subject to Washington's business and occupation (B&O) tax.

Definitions

For purposes of this ETA, the following definitions apply:

"Bona fide discounts"[2]: When a sale is made subject to cash or trade discount, the gross proceeds actually derived from the selling price are determined by the transaction as finally completed. A sale is made subject to a discount when the sales price is reduced under terms known to the buyer and seller at the time of the sale, and the price reduction occurs at the time of the sale or within a time agreed and understood by the parties at the time of the sale.

The selling price or sales price of a service or article of tangible personal property does not include bona fide discounts actually taken by the buyer. The amount of bona fide discounts may be deducted only if the amount has been included in the gross amount reported.

Discounts are not deductible when the retail sales tax is based on the selling price or sales price before the discount is taken and no portion of the tax is refunded to the buyer.

[1] The exemption for qualifying scan-down allowances is effective July 28, 2019.
[2] Washington Administrative Code (WAC) 458-20-108(7).

"Scan-down allowance"[3]: Generally, a scan-down allowance is a payment or credit offered to a seller by a manufacturer or wholesaler of food or pet food products to a grocer based on the quantity of the product sold during a specified period of time. When certain requirements are met, the scan-down allowance (the payment or credit) can be deducted from gross income. Food or pet food products are defined in RCW 82.08.0293 and RCW 15.53.901.

"Incentive": a payment or credit provided by a manufacturer, distributor, or wholesaler to a retail grocer related to wholesale purchases.

"Incentive Program": An arrangement in which a manufacturer, distributor, or wholesaler provides a payment or credit to the retail grocer related to wholesale purchases.

Grocer Discounts in General (Required Conditions)

Bona fide discounts are not subject to B&O tax. Under WAC 458-20-108, when a sale is made subject to cash or trade discount, the gross proceeds actually derived from the contract and the selling price are determined by the transaction as finally completed. In addition, the selling price of a service or of an article of tangible personal property does not include the amount of bona fide discounts actually taken by the buyer, and the amount of such discount may be deducted from gross proceeds of sales.

The Department's long-standing position is that a discount is not bona fide if it is in exchange for a service or benefit, whether done pursuant to a written contract, business practice, or oral agreement.

Generally, a bona fide discount negotiated by the grocer upon purchase of the goods does nothing more than encourage the grocer to make sales they were already going to make. However, if a grocer performs a service in addition to selling the goods in exchange for the discount, then the discount is not bona fide.

Although grocers, distributors, or manufacturers may refer to their *incentive* programs as *discount* programs, the payments or credits provided under these programs may not be bona fide discounts if the requirements are not met or a service or activity is required in return for the incentive.

In cases where a retail grocer sells a product subject to a bona fide discount from a manufacturer or distributor, the Department taxes the final transaction after factoring in the retail grocer's savings.

***Grocer Discounts**: Required Conditions*

Grocer incentives are bona fide discounts, not subject to B&O tax, when the following conditions are met:

[3] Engrossed House Bill 1354 (Chapter 217, Laws of 2019).

1) The sales price is reduced under terms known to the buyer and seller at the time of the sale,
2) The price reduction occurs at the time of the sale or within a time agreed and understood by the parties at the time of the sale; and,
3) The discount is not in exchange for the performance of a service or business activity by the retail grocer.

The term “business” is not limited to services provided by the retail grocer to the manufacturer or distributor, but includes all activities engaged in with the object of gain, benefit, or advantage to the retail grocer (or to another person or class), directly or indirectly. Types of activities or services that the retail grocer might be required to perform include, but are not limited to, advertising, slotting preferences, selling the goods during a certain time frame, and sales pricing requirements.

Common Grocer Incentive Programs That Qualify as Bona Fide Discounts

Generally, the following common grocer incentive programs will qualify as a bona fide discount if the *grocer incentives* required conditions (as described above) are satisfied:

Off-invoice Discounts. Manufacturer or distributor discounts that are directly written off on the sales invoice to retail grocers.

- Manufacturer offers $1.00 discount per case of product purchased by the retail grocer at the time of sale. The discount is immediately known and applied toward the purchase price, and generally not displayed on the sales invoice.

Volume Discounts. Manufacturer or distributor discounts that are determined by the volume of product purchased by the retail grocer at the time of sale. Generally, volume discounts are written off on the sales invoice to retail grocers.

- Manufacturer offers $0.50 discount per case of product purchased by the retail grocer up to 100 cases and a $1.00 discount per case of product purchased by the retail grocer in excess of 100 cases. The discount is immediately known and applied toward the purchase price.

Contractual Discounts. Manufacturer or distributor discounts that are not limited to an isolated or standalone sale. Generally, contractual discount arrangements are established for a designated period of time or as ongoing agreement with retail grocers who regularly purchase their products. Contractual discounts are commonly used in cases where the parties want to maintain a set discount rate for all of manufacturer or distributor’s products, rather than determine discounts or prices of products on an individual basis.

- Manufacturer offers a 5% contractual discount to a retail grocer based on the recurring nature of the parties' business relationship. The discount is immediately known and applied to the purchase price at each point of sale between the manufacturer and the retail grocer.

Common Grocer Incentive Programs That Do Not Qualify as Bona Fide Discounts

The following common grocer incentive programs will generally not qualify as a bona fide discount because the person providing the allowance receives a service or benefit in return:

Advertising Allowances. An example of an advertising allowance is when a grocer receives some form of payment or credit from a distributor for advertising a distributor's products in print, on the Internet, or in the grocer's place of business.

Exclusivity Allowances. An example of an exclusivity allowance is when a grocer receives some form of payment or credit from a distributor for carrying only the distributor's products to the exclusion of competitor's similar products. For example, a laundry detergent distributor provides a discount to a grocer if the grocer agrees not to stock laundry detergents sold by other distributors.

Placement (Slotting) Allowances. An example of a placement allowance is when a grocer receives a payment or credit from a distributor for introducing a product line in the store or for placing a product in certain locations or in certain displays in the store.

Membership Discounts. An example of a membership discount is when a grocer receives a payment or credit from a distributor for including a product in the grocer's membership club program, which might include being listed in club program advertisements, in store notices, product displays, or aisle tags.

The discounts described above are generally received in exchange for services, and such income is reported as taxable gross income, generally subject to Service & Other B&O tax. See Det. No. 98-172E, 18 WTD 387 (1999).[4]

Indicators That Services are Provided in Exchange for a Discount

Examples of indicators that suggest a grocer is providing a service in exchange for a discount or incentive include, but are not limited to:

Indicators of Service in Exchange
Written contract or enforceable right requiring performance by grocer
Ad copy is provided by vendor and vendor requests confirmation or other information about the use of the supplied ad copy, such as that a copy of the ads run be sent to the vendor
Invoice that contains a check box to indicate whether the

[4] This ETA does not address other exemptions or deductions that may apply, such as Cooperative Advertising Allowances for Qualified Grocery Distribution Cooperatives under RCW 82.04.298 and Det. No. 98-172E, 18 WTD 387 (1999).

grocer used the ad copy
Discount payments are accounted for as an income stream on the general ledger
Accounting entry lists the discount as an "advertising allowance," "promotional effort," or other term indicating a service was performed

This list of indicators is not exhaustive. These are merely examples of the types of conditions that indicate an activity performed by a grocer may be a service to the wholesaler or manufacturer as a condition of the incentive or discount. In cases where no conditions are present to indicate a service has been provided, the incentive or discount is presumed to be bona fide if the other requirements of a bona fide discount are met.

Examples (Grocer Incentive Programs)

The following examples identify a number of facts and then state a conclusion. These examples should only be used as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

Example 1 (Qualifying Off-Invoice Discount Arrangement):

- **Facts:** Puget Foods (Puget) is a retail grocery store. Puget enters into a purchase and sales agreement with Roma Frozen Pizza Distributors (Roma) to purchase frozen pizzas from Roma at $4.00 a pizza. Roma, who is a distributor for Sal's Pies (pizza manufacturer), ordinarily sells each pizza for $5.00. Sal's Pies enters an agreement with Roma to an off-invoice discount of $1.00 for each pizza sold to Puget. The sale between Roma and Puget occurs on January 2, 2020. The discount is known by both parties and provided at the point of sale and includes no other conditions.

  Puget purchases 1,000 frozen pizzas from Roma for $4,000. The sales invoice to Puget displays a purchase price of $4,000.Puget believes the pizzas will be in high customer demand, once customers have had a chance to try the pizza. Being that the product is new, not many customers are familiar with the brand. To give the product better exposure, Puget displays the frozen pizzas for sale in the freezer located at the end of the frozen food aisle.

- **Result:** The off-invoice deduction represents a bona fide discount to Puget. Puget is not subject to B&O tax on the $1,000 discount received from Roma. The fact that Puget specially displays the product in order to increase demand does not disqualify it from being a bona fide discount, as the product placement element is not a required condition for the discount, even though Puget gave the product preferential display over other brands of frozen pizza products.

Example 2 (Qualifying Volume Discount Arrangement):

- **Facts:** Puget Foods (Puget) is a retail grocery store. Puget enters into a purchase and sales agreement with Taters Potato Product Wholesalers

(Taters) to purchase bags of frozen potato products. Taters' listed sales price is $2.00 per bag of frozen potato products. In order to increase Puget's purchase order, Taters offers Puget a volume discount of $0.25 per bag if Puget purchases a minimum of 2,000 bags. The discount is known by both parties and provided at the point of sale and includes no other conditions.

Puget purchases 2,000 bags of frozen potato products from Taters for $3,500. The sales invoice displays a non-discounted purchase price of $4,000 and a separate line entry for the volume discount amount of $500. Puget's frozen storage space is limited. As a result of the large purchase from Taters, Puget will exclude other frozen potato product brands it normally sells from its sales inventory for the foreseeable future.

- **Result:** The volume deduction represents a bona fide discount to Puget. Puget is not subject to B&O tax on the $500 discount received from Taters. The fact that Puget will exclude other brands of similar products from its sales inventory as a result of the purchase from Taters does not disqualify it from being a bona fide discount, as the exclusivity element is not a required condition for the discount, even though Puget excluded other brands as a result of the purchase.

  Note: Had Taters required Puget to exclusively sell its products by not selling competing brands as a condition of the volume discount, the $500 discount would be subject to B&O tax, as the discount represents payment to Puget in exchange for sales promotion services (limiting other competition) to Taters.

Example 3 (Qualifying Contractual Discount Arrangement):

- **Facts:** Puget Foods (Puget) is a retail grocery store. Puget enters into a contractual discount arrangement with Fresh Green Produce Distributors (Fresh), from whom Puget regularly purchases its fresh produce. Under the agreement, Fresh agrees to provide Puget a 5% contractual discount on all produce purchased by Puget.

  On January 2, 2020, Puget purchases $5,000 in fresh fruit and vegetable produce from Fresh. The sales invoice displays a non-discounted purchase price of $5,000 and a separate line entry for the contractual discount amount of $250. Puget has a reputation with its customers of offering the best vegetable produce in the region, most notably its wide selection of vegetables that are not regularly available at other grocery stores. In order to keep its customers apprised of its current vegetable offerings, Puget regularly advertises Fresh's produce in its weekly sales flyer (published in local newspapers and sent to local residents via US mail). At the convenience of Puget, Fresh provides a list of suggested products for advertisement based on what it will have available for sale to Puget in the near future.

- **Result:** The contractual deduction represents a bona fide discount to Puget. Puget is not subject to B&O tax on the $250 discount received from Fresh. The fact that Puget regularly advertises Fresh's products in its weekly sales flyer (and does so based on Fresh's suggestions) does not disqualify it from being a bona fide discount, as the advertising element is not a required condition for the discount, even though Puget advertises Fresh's vegetable produce regularly.

  Note: Had Fresh required Puget to advertise its products in Puget's weekly sales flyer as a condition of the contractual discount, the $250 discount would be subject to B&O tax, as the discount represents payment to Puget in exchange for advertising services.

Scan-Down Allowances for Grocers

Effective July 28, 2019, scan-down allowances for food and pet food products sold to retail grocers for resale to the grocer's customers during a certain period, are not subject to the B&O tax.[5] The scan-down allowances may be conditioned upon the grocer's sale of the products at a certain price or price reduction. The B&O tax exemption for scan-down allowances is only available to retailers of food and pet food products, and not to manufacturers or distributors of food and pet food products.

A scan-down allowance is a payment or credit offered to a seller by a manufacturer or wholesaler of food or pet food products where:

(i) The amount of the payment or credit is based on the quantity of the product to be sold at retail by the seller within a specified period of time;

(ii) The seller knew the terms of the offer before making the sales that generated the payment or credit from the manufacturer or wholesaler; and

(iii) The seller is not required to provide any services to the manufacturer or wholesaler or engage in any business activities directly or indirectly benefiting the manufacturer or wholesaler, in order to receive the payment or credit from the manufacturer or wholesaler.

Often, the manufacturer or wholesaler may require the seller to sell the items at a specific or reduced retail price. For purposes of this deduction, this requirement is not considered a service or business activity provided to or benefiting the manufacturer or wholesaler.

Generally, the terms of the manufacturer or distributor discount are determined at the point of sale to the retail grocer. However, in the case of a scan-down allowance, the resulting discount amount is determined based on the quantity of

[5] Engrossed House Bill 1354 (Chapter 217, Laws of 2019).

the purchased product subsequently sold by the retail grocer, often within a pre-determined period of time after the sale.

Example

Manufacturer offers $1.00 discount per case of product purchased and subsequently sold by the retail grocer within a pre-determined time period. The discount is determined at the end of the pre-determined time period, based on how many sales were completed by the retail grocer. Generally, the resulting payment or credit is either issued as a separate credit on a future invoice or as a direct payment. As a condition of the agreement, the retail grocer is required to reduce the product's sales price to end consumers by the $1.00 discount amount.

Taxability of scan-down allowances prior to July 28, 2019

Prior to the July 28, 2019 effective date of the scan-down allowance deduction, scan-down allowances were regarded as bona fide discounts in ETA 3173.2013. A 2015 appellate case undermined that conclusion.[6] While scan-down allowances do not qualify as bona fide discounts, the Department will accept the tax reporting treatment as such for periods prior to the July 28, 2019 effective date of the scan-down allowance deduction.

Examples (Scan-Down Allowances)

The following examples identify a number of facts and then state a conclusion. These examples should only be used as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

Example 4 (Qualifying Scan-Down Allowance Arrangement):

- **Facts:** Evergreen Foods (Evergreen) is a retail grocery store. Evergreen enters into a purchase and sales agreement with Rainier Food Wholesalers (Rainier) to purchase canned soups from Rainer at $2.00 a can. The sale occurs on December 13, 2019. As part of the agreement, Rainier offers Evergreen a $0.20 scan-down allowance on each can of soup sold during the month of January 2020. The agreement does not stipulate any advertising, exclusivity, or product placement requirements. Additionally, the scan-down allowance does not apply to sales of Rainier canned soup already in Evergreen's inventory. As part of the agreement, Evergreen is required to pass along the incentive to its customers by reducing the product's retail price by $0.20.

  Evergreen purchases 1,000 cans of soup from Rainer for $2,000. During the month of January 2020, Evergreen sells 500 cans of soup. Rainer issues a credit of $100.

[6] *See Steven Klein, Inc. v. State*, 183 Wn.2d 889, 901, 357 P.3d 59 (2015) (auto manufacturer's "dealer cash" payments to auto dealer not bona fide discounts because not necessarily quantified or knowable when dealer purchased vehicles at wholesale).

- **Result:** The scan-down allowance qualifies for the B&O tax deduction. Evergreen is not subject to B&O tax on the $100 scan-down allowance credit received from Rainier. The fact that Evergreen is required to reduce the sales price of the canned soup to its customers is not a disqualifying business activity or service to Rainier.

Example 5 (Qualifying Scan-Down Allowance Arrangement):

- **Facts:** Assume the facts from Example 4, except that Evergreen will advertise Rainer's canned soup in its December 2019 sales flyer. Additionally, Evergreen creates a standalone sales display stocked with Rainer's canned soup in its store. Neither the advertising nor sales display were required by Rainier as a condition of the scan-down allowance agreement.

- **Result:** The scan-down allowance qualifies for the B&O tax deduction. Evergreen is not subject to B&O tax on the $100 scan-down allowance credit received from Rainier. The fact that Evergreen elected to advertise and separately display Rainer's product on its own behalf does not impact the qualifying nature of the discount. Had Rainier required Evergreen to engage in either activity as a condition of the scan-down allowance, the credit received by Evergreen would be subject to B&O tax.

Example 6 (Non-Qualifying Scan-Down Allowance Arrangement):

- **Facts:** Assume the facts from Example 4, except that as a condition of the scan-down allowance agreement, Evergreen is required to add a peelable sticker to each can of soup that displays: the $0.20 savings amount and other promotional information regarding Rainier's line of products.

- **Result:** The scan-down allowance credit of $100 is subject to B&O tax because Evergreen is required to perform a service (promotional advertisement of Rainier's products) as a condition of the scan-down allowance. Had Evergreen elected to promote Rainier's products through the use of a peelable sticker at its own discretion (and all other requirements were met), the scan-down allowance credit would not have been subject to the B&O tax.

Example 7 (Non-Qualifying Scan-Down Allowance Arrangement):

- **Facts:** Assume the facts from Example 4, except that instead of canned soup, Rainer is selling can openers to Evergreen.

- **Result:** The scan-down allowance credit of $100 is subject to B&O tax due to the fact that Evergreen is required to perform a business activity (the sale of can openers within a designated time period and at a certain price to retail customers) as a condition of the scan-down allowance credit. In addition, the product is not a food or pet food product. Only food and pet food products qualify for the deduction.

Rebuttal and Records Retention	Retail grocers receiving a bona fide discount when there is an indicator of a link between a business activity and the discount may rebut the presumption created by the indicator by producing the necessary records documenting that these transactions are unrelated to a business activity. Retail grocers receiving a scan-down allowance for food or pet food products when there is an indicator of a link between a service and the scan-down allowance may rebut the presumption created by the indicator by producing the necessary records documenting that these transactions are unrelated to a service. Proper documentation to support any claimed deduction or exemption is required under the law. Under RCW 82.32.070, taxpayers must keep and preserve suitable records. If taxpayers do not keep accurate records and there are indicators that a service or business activity (depending on the discount type) was provided in exchange for the discount, then additional information may be requested to determine if the discounts are bona fide or qualify for the scan-down allowance deduction.

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