

Travel, Hospitality & Leisure Spotlight

THL Deals You Can Account On

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The Bottom Line

When evaluating the arrangement, the THL entity must first determine whether a given transaction simply represents a normal (two-party) sale between the THL entity and the deal company.

- As more and more consumers seek bargains on the Web, entities in the travel, hospitality, and leisure (THL) industry are increasingly relying on online deal coupon companies (“deal companies”) to promote their products and services at reduced prices and thereby attract new and existing customers. Online deals take various forms. In many arrangements, consumers pay the deal company up front in exchange for a coupon that they later present to the THL entity for redemption; in others, customers buy the product or service directly from the THL entity by paying it the discount price advertised on the coupon.
- How a THL entity should account for its deal coupon transactions will depend on the terms and conditions of the arrangement. When evaluating the arrangement, the THL entity must first determine whether a given transaction simply represents a normal (two-party) sale between the THL entity and the deal company. If the transaction does not constitute such a sale, the THL entity must use the indicators in ASC 605-45¹ to determine whether it acts as a principal or an agent in the transaction. If the entity concludes that it acts as a principal, it will generally report its revenue from the transaction on a gross basis (i.e., revenue will be the amount that the consumer paid for the product or service). If the entity determines that it acts as an agent, it will report its revenue from the transaction on a net basis (i.e., the amount that the consumer paid for the product or service, less the deal company’s fee).
- In addition to affecting a THL entity’s accounting, online deal transactions may have tax and escheatment implications. For example, advance payments from the sale of online deal coupons may qualify for deferred revenue recognition from a tax perspective. Moreover, deal coupons that are expired or unlikely to be redeemed may subject the THL entity to escheatment liability depending on the terms of the transaction, the entity’s method of accounting for the coupons’ “breakage,” and applicable state laws.
- THL entities should closely monitor their accounting and tax policies related to online deal transactions and modify them if necessary to address changes in the terms of the deal arrangements.

¹ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.”

Beyond the Bottom Line

This *Travel, Hospitality & Leisure Spotlight* highlights accounting, tax, and escheatment implications that THL entities should consider when evaluating the impact of their arrangements with deal companies.

Background

Deal companies offer discounts on various products and services, including those of interest to THL consumers. In an age of economically savvy consumers, online deals are becoming ever more popular in U.S. consumer markets. Deal company transactions rose dramatically in 2012. The vast growth of smartphone technology and mobile applications has contributed to the development of the online deal business, creating an environment in which customers can access the newest and cheapest local deals simply by tapping a touchscreen.

Many THL entities are turning to deal companies for help with advertising and selling significantly discounted goods and services, including airline flights, food and beverages, hotel accommodations, recreation, resort packages, and spa treatments. By leveraging the deal companies' distribution channels and the ability of consumers to act instantly upon receiving an online offer, THL entities can potentially boost consumer activity during nonpeak times.

A deal company typically uses its own Web site or mobile application to advertise discounted products and services and allow consumers to purchase them. Often, the consumer pays the discount price to the deal company up front and later redeems the coupon by presenting it to the THL entity. While terms and conditions vary, online deal arrangements usually allow the deal company to receive payment from the consumer, retain a portion of the consideration, and submit the remaining consideration to the THL entity. In some arrangements, the consumer buys a product or service directly from the THL company for the price advertised on the deal company's coupon.

The accounting for deal coupon transactions can vary depending on the goods and services offered and the specific terms of the arrangement between the THL entity and the deal company. For example, a hotel may offer (1) a deal coupon for a meal at the hotel's restaurant that is redeemable for a stated amount with no expiration date (similar to a gift card) or (2) a deal coupon for a hotel stay that is redeemable on a specific date (essentially a prepaid hotel stay). Although the two deals share similarities, the accounting for them should be evaluated separately since their differences could significantly affect the amount of revenue recognized, the timing of such recognition, and the related tax accounting for each transaction.

Revenue Recognition Considerations

A key consideration in evaluating arrangements with deal companies is whether the THL entity is acting as a principal or an agent in the arrangement. ASC 605-45 identifies the sale of goods or services over the Internet as one of the more common arrangements for which entities must determine whether to recognize revenue on either (1) a gross basis (as a principal) or (2) a net basis (as an agent). Before making such a determination, entities may first need to evaluate whether the transaction simply represents a normal (two-party) sale between the THL entity and the deal company. If the transaction is for the sale of goods or services between the THL entity and the deal company regardless of whether the deal company resells or provides the goods or services to its own subscribers, the guidance in ASC 605 may indicate that a sale has occurred between the THL entity and the deal company. For example, an entity (such as a deal company) may purchase a block of rooms from a hotel to resell to its own customers and pay for the rooms regardless of whether the rooms are used. In such a case, the transaction may be a normal sale between the hotel and the entity (not the entity's customers). On the other hand, a deal company may, on its Web site or mobile application, offer its subscribers deals for discount hotel stays that are subject to the hotel's terms and conditions; in that case, the company should consult ASC 605-45 to determine whether the hotel or the deal company is acting as the principal in the arrangement.

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ASC 605-45 lists the following indicators that an entity should consider in determining whether to report revenue on a gross basis (as a principal in the arrangement) or on a net basis (as an agent in the transaction):

Indicators of Gross Revenue Reporting (Principal)	Indicators of Net Revenue Reporting (Agent)
<p>It may be appropriate for an entity to report revenue as a principal on a gross basis if the entity:</p> <ul style="list-style-type: none"> • Is the primary obligor in the arrangement.* • Faces general inventory risk before a customer's order is placed or upon a customer return.* • Has latitude in establishing price. • Changes the product or performs part of the service. • Has discretion in selecting the supplier. • Participates in determining specifications for the product or service. • Faces the risk of physical loss of inventory after a customer places an order or during shipping. • Faces a credit risk. 	<p>It may be appropriate for an entity to report revenue as an agent on a net basis if:</p> <ul style="list-style-type: none"> • The entity's supplier is the primary obligor in the arrangement.* • The amount the entity earns is fixed. • The supplier faces a credit risk.
<p>* Strong indicator.</p>	

If, on the basis of these indicators, a THL entity determines that it is the principal in an online deal arrangement, it would recognize the gross amount of revenue earned (i.e., the amount paid by the consumer). Conversely, if the THL entity determines that it is acting as an agent, it would report revenue from the arrangement on a net basis (i.e., net of the fee retained by the deal company). A critical assessment is determining whether the entity is responsible for providing the good or service to the customer (i.e., the primary obligor) since under ASC 605-45, an entity's status as the primary obligor would be a strong indicator that the entity should report revenue from the arrangement on a gross basis.

Examples
<p>Example 1</p> <p>A hotel enters into an arrangement with a deal company to sell a deal coupon for a two-night stay at the hotel for a specified weekend. Under the terms of the arrangement, the deal company will be responsible for marketing (e.g., notifying its subscribers about the deal) and selling the deal coupon (valued at \$200) for \$100. When a sale occurs, the consumer pays the deal company the \$100 and the deal company remits \$60 to the hotel. The consumer redeems the deal coupon upon staying at the hotel. In accordance with ASC 605-45, the hotel would need to determine whether to report revenue on a gross basis (as the principal in the arrangement) or on a net basis (as the agent in the transaction). That is, the hotel would need to determine whether to report (1) gross revenue of \$100 and \$40 of expense as the principal or (2) net revenue of \$60 as an agent. The hotel may conclude that gross reporting is appropriate in this case because it not only was the primary obligor (principal) solely responsible for fulfilling the consumer's order (i.e., giving the consumer the right to use the hotel services) but it also had latitude in establishing the price of the deal.</p>
<p>Example 2</p> <p>A deal company purchases 100 gift cards (valued at \$100 each) from a restaurant for an up-front, nonrefundable payment of \$4,000. Each gift card is marketed on the deal company's Web site for consumers to purchase for \$50 and can be exchanged for \$100 worth of food and beverage at the restaurant. The deal company assumes general inventory risk and can set the price of the gift cards to be sold on its Web site. The deal company also assumes the risk of collecting the price to be paid by the consumer (credit risk). Although the restaurant would ultimately provide the service to the consumer (and may be deemed the primary obligor in the arrangement), under ASC 605-45 the restaurant may conclude that revenue should be presented on a net basis; however, as discussed above, the arrangement may be viewed as a normal sales transaction between the restaurant and the deal company (a reseller). Also, the restaurant would still need to consider when to recognize the revenues in accordance with ASC 605 (i.e., when the goods have been delivered or services have been rendered).</p>

A critical assessment is determining whether the entity is responsible for providing the good or service to the customer (i.e., the primary obligor) since under ASC 605-45, an entity's status as the primary obligor would be a strong indicator that the entity should report revenue from the arrangement on a gross basis.

Understanding the specific terms and conditions of each arrangement is critical to ensuring that revenue and expenses are accounted for appropriately.

In the evaluation of arrangements under ASC 605-45, the THL entity often is deemed to be the principal in the transaction since it is frequently the party responsible for providing the good or service to the consumer who purchased the deal coupon. Revenue would therefore be reported on the basis of the gross amount paid by the ultimate consumer, and any difference between the reported amount and the actual consideration received would be reported as an expense paid to the deal company (the agent in the transaction). In certain circumstances, it may be difficult for THL entities to obtain enough information about the consideration the deal company received from the consumer to report revenue on a gross basis, in which case alternative reporting (e.g., on the basis of the consideration received from the agent) may be acceptable; however, entities should consult their accounting advisers before using an alternative reporting approach.

The terms and conditions or structure of each arrangement may differ and could result in varying accounting outcomes. The THL entity would also have to consider when to expense the fees paid to the deal company (i.e., at the time the coupon was purchased or upon redemption by the consumer). Understanding the specific terms and conditions of each arrangement is critical to ensuring that revenue and expenses are accounted for appropriately.

The considerations above are more appropriate for owner/operator entities than managers or franchisors of hotel or restaurant brands. A manager or franchisor generally recognizes only management or franchise fees; therefore, the revenue recognition considerations for deal coupons discussed above may not apply to a manager's or franchisor's revenue arrangements. However, since management and franchise arrangements are frequently based on a percentage of revenues, the manner in which revenue is reported and recognized by a THL entity in an arrangement involving deal coupons could affect the amount received in management or franchise fees.

In addition, a THL entity may need to consider the guidance in ASC 605-50 if the deal company is also a customer of the THL entity. ASC 605-50 provides guidance on accounting for consideration given to a customer. Such consideration can take various forms, including credits toward purchases, cash payments, free products or services, sales incentives, discounts, rebates, and price reductions. Under the guidance in ASC 605-50, it is presumed that any consideration given to a customer (e.g., a commission paid by a THL entity to a deal company that is also a customer of the THL entity) should be recorded as a reduction of the revenue from that customer; however, this presumption can be overcome if certain criteria are met. Specifically, to overcome this presumption, the THL entity must receive an "identifiable benefit (good or service) in exchange for the consideration" and must be able to "reasonably estimate the fair value" of such benefit. If those criteria are met, the consideration would be recorded as an expense rather than a reduction of revenue.

Tax Implications

Deal coupon arrangements may have income tax, sales tax, and use tax implications. For example, the timing and amount of revenue recognized for book purposes may differ from the manner in which revenue is recognized for tax purposes. Revenue is often taxed on a cash basis; however, there are exceptions for advance payments, such as advance payments received for deal coupons. In addition, certain sales and use taxes are based on gross sales; accordingly, the assessment discussed above for financial reporting may also be important for calculating certain taxes other than income tax.

Breakage and Escheatment Implications

Some deal coupons may require the THL entity to provide a good or service on a specific date or over a specific period, or that the consumer perform an action to redeem the coupons. A consumer's failure to use the deal coupon, or the remote likelihood that the deal coupon will be redeemed, is often referred to as breakage. In such cases, the THL entity may need to determine (1) whether the breakage is subject to escheatment to a state (assuming that the entity is responsible for the escheatment liability) or (2) when and how to recognize the breakage as income to the entity.

To the extent that a THL entity is not obligated to remit unused deal coupons to the state, it should establish a policy for determining how and when to recognize deferred revenue related to unused deal coupons (i.e., breakage) in light of the specific facts and circumstance of each arrangement.

Because escheatment laws vary from state to state, THL entities will need to evaluate (1) the legal terms of and conditions in their arrangements with deal companies and (2) the escheatment laws in the applicable state to determine whether unused deal coupons require escheatment to the state.

To the extent that a THL entity is not obligated to remit unused deal coupons to the state, it should establish a policy for determining how and when to recognize deferred revenue related to unused deal coupons (i.e., breakage) in light of the specific facts and circumstance of each arrangement. Entities generally use one of two approaches to recognize breakage:

- Breakage is determined for each deal coupon and recognized when the entity is legally released from its obligation to the consumer (e.g., the deal coupon expires or the possibility of redemption becomes remote).
- The estimated value of the deal coupons that are expected to go unused in a homogeneous pool sold over a certain period is recognized in proportion to the recognized value of the redeemed deal coupons in that pool. To use this method appropriately, entities must be capable of reasonably and objectively determining the amount of breakage and the period over which revenue from the used deal coupons is recognized.

Under either approach, the estimated value of breakage and the period over which it is recognized must be supported by (1) sufficient historical evidence that represents future outcomes and (2) a remote likelihood that material adjustments would be made to amounts already recognized as revenue.

Thinking Ahead

Deal coupons will remain valuable marketing and advertising tools for raising brand awareness and reaching new and existing customers. However, they can present accounting and tax challenges as the terms of arrangements change. Given the growth of the online deal industry, THL entities should perform detailed reviews of their arrangements with deal companies, as well as their accounting and tax policies, to ensure that they have adequately considered the accounting and tax implications discussed above.

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