TRAVEL, HOSPITALITY & LEISURE

# Taxing Times? Hyatt Ruling May Drive Cross-Industry Loyalty Impacts

## Loyalty Programs: Taxes at the Forefront

In the world of hospitality, loyalty programs have become indispensable tools for fostering customer retention and brand loyalty. How these programs are funded is important for program viability and overall ROI. However, they create tax implications, which have recently taken center stage with a prominent case involving Hyatt Hotels shedding light on the complexities of loyalty program taxation. In this article, we delve into the intricacies of loyalty program tax implications, utilizing Hyatt's case as a prime example, and explore what this might mean for other companies in the hospitality, restaurants and related industries.

## Revenue, Direct Expenses, and Advertising and Partnership Costs

Before we review the case, it’s important to understand that loyalty programs are not just a means of rewarding customers, they are also a source of revenue. Companies generate income and expenses from various sources which create complexities from timing, beneficiaries and ownership, all of which have tax and accounting implications.

**Revenue:** Loyalty programs generate substantial revenue through membership fees, points redemption fees, points sales to credit card partners and even the sale of customer data to third parties. Loyalty drives top-line revenue and directly are significant contributors to profitability.

**Direct Expenses:** Running a loyalty program has major costs associated, such as the cost of points awarded to customers, hotel reimbursements, customer service operations and technology infrastructure. Effectively managing the program expenses can impact a company's profitability as well as the underlying financial liabilities. Forbes recently estimated the liability for unredeemed airline miles and hotel loyalty points in the United States to be approximately $14 billion.

**Advertising and Partnership Costs:** Promotional activities and partnerships with other businesses are common features of loyalty programs. Jointly promoting loyalty programs and the related performance obligations allows both partners to maximize the value of the program. The costs associated with advertising campaigns and forming partnerships can generate tax complexities along with opportunities to reduce expenses.

## Hyatt Case Summary

The case of Hyatt Hotels Corporation provides a prime example of the intricate tax implications that loyalty programs can bring about, as well as highlights opportunities for the future. There are two main factors which drove the ruling.

**Hyatt's Loyalty Program:** Hyatt operates a loyalty program not only for its own hotels but also for Hyatt-branded hotels owned by third parties. Hyatt owns a significant portion of its properties unlike some others in the industry.

**Payment from Participating Hotels:** Hyatt receives payments from these participating hotels in exchange for its services in running the loyalty program. These services include administrative tasks and value-added services.

**IRS Ruling:** The Internal Revenue Service (IRS) concluded that Hyatt should be subject to U.S. Federal income tax on the payments it received from the other hotels dating back to 2009. This decision was based on nuances in the contractual arrangements and the benefits Hyatt directly received from the program.

## What This Could Mean to Other Loyalty Programs

The implications of the IRS ruling in the Hyatt case could ripple across various industries:

### Hospitality

Many major hotel chains manage their programs differently than Hyatt currently and have lower ownership of properties generally. Although, there is potential for a need to change different aspects outside the core hotel earning and redemption elements. Additionally, smaller hotel chains with loyalty programs may also face scrutiny regarding the tax treatment of payments received from third-party hotel owners. Hotel ownership groups with significant scale and/or concentration to Hyatt also may face scrutiny, as even though private, they receive benefits and pay expenses related to the loyalty program which may need to be adjusted for prior periods and changed going forward.

### Restaurant

Quick service restaurants, similar to hotel groups, operate significant loyalty programs with billions of dollars flowing through annually. The redemptions are of smaller material value but transactions much more frequent, so in aggregate there are meaningful tax implications. The industry may differ, but the concepts are shockingly similar in structure, purpose and beneficiary concept. Programs are managed and accounted for in a variety of ways but generally boil down to holding a liability on the balance sheet or pre-paid customer funds. In any of the cases, as a result of the Hyatt ruling, there are potential tax implications and future opportunities.

### Other Related Industries

Other hospitality and similar industries have loyalty programs but are the material owners of their operations and assets since they are highly capital intensive. While the impacts of the Hyatt tax case may not have direct implications to the core programs, there is potential that certain aspects of the program such as partnerships & alliances and potentially others aspects that may see impacts.

**Airlines:** Carriers often have extensive and complex loyalty programs and significant cross-border alliance programs. They could face similar tax challenges, as they collaborate with other airlines or partners across the globe.

**Cruise Lines:** While lesser known for their loyalty programs and primarily non-US entities, cruise lines might find themselves in a similar position as Hyatt. There is potential as they evolve their loyalty programs, with increasingly new partners as US companies, to face additional tax complexity.

**Rental Cars:** Rental companies have largely owned fleets, a mix of ownership models and an evolving electrified fleet. These factors make it a real potential for tax complexities to arise. Combined with the clear linkage of asset utilization to individual rewards, it is likely that opportunities will arise to generate tax benefits as well as ensure compliance.

## What Companies Should Think About

Companies operating loyalty programs should carefully consider the following factors:

### Program Re-Design

Companies may need to re-evaluate the structure of their loyalty programs to mitigate the costs of potential new tax liabilities that could arise. Assessing what benefits have the biggest impact to loyalty (and associated cost) is critical to not alienating customers and franchisees, but also limiting the costs and impacts to the parent company.

### Functional Structuring and Ownership

The way loyalty program functions are structured, especially when dealing with third parties, needs to be scrutinized to ensure compliance with tax regulations. Determining the ownership structure of loyalty programs and the allocation of revenue and expense is crucial for tax planning. Considering the structure of ownership of the program may need to be revisited including the potential for creation of new entities and ventures.

## How Alvarez & Marsal Can Help

Navigating the intricate world of loyalty program tax implications requires expert guidance. Alvarez & Marsal, with its deep expertise in taxation and business advisory services, can provide invaluable assistance. From program redesign to strategic structuring, Alvarez & Marsal can help companies adapt to changing tax landscapes while maximizing the benefits of their loyalty programs.

**Experience Design:** Leveraging our expertise across industries, operations and organizational improvements to enhance customer journeys, streamline processes and drive innovation, ultimately creating a more engaging and efficient loyalty experience.

**Strategy and Planning:** A&M can assist companies in developing comprehensive tax strategies that align with their business goals. This includes identifying opportunities for tax savings, optimizing tax structures and ensuring compliance with changing tax regulations. By crafting effective tax plans, A&M helps companies reduce their tax liabilities while remaining compliant.

**Tax Compliance and Reporting:** A&M's experts can streamline and improve tax compliance processes. They ensure that companies adhere to all tax filing requirements, prepare accurate and timely tax returns, and implement efficient reporting systems. This minimizes the risk of penalties and audits while maintaining transparency with tax authorities.

**Tax Controversy and Resolution:** A&M specializes in handling tax controversies and disputes. When companies encounter tax-related issues, such as audits or disagreements with tax authorities, A&M can provide expert guidance and representation. They work to resolve disputes efficiently and in a manner that minimizes financial and reputational risks for their clients.

In conclusion, loyalty programs offer a valuable avenue for companies to engage with customers and generate revenue. However, recent developments, such as the Hyatt case, underscore the importance of understanding the tax implications associated with these programs. Companies in various sectors should proactively assess their loyalty program structures and seek to ensure compliance with tax regulations while continuing to reap the rewards of customer loyalty.

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