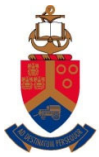

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TAXING CUSTOMER LOYALTY PROGRAMMES: AN INTERNATIONAL PERSPECTIVE

by

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ABSTRACT

Customer loyalty programmes (CLPs) have become prevalent in various economies, which is indicative of a change in the nature of the economic transactions occurring between businesses and customers. Interestingly, research indicates that there has been no change in how these transactions are taxed in South Africa that corresponds with the change in business. In general, the South African tax system provides for tax revenue to fund the expenditure incurred by the South African government. Therefore, the taxation of CLP rewards in the hands of customers should increase tax revenues, which South Africa urgently needs as the government has consistently spent more than it has have received in recent years. Furthermore, it is acknowledged that the South African government needs additional tax revenue because of the damages caused by the COVID-19 pandemic, which has caused severe disruptions to economies over the world.

This study contributes by using a doctrinal research methodology to analyse the tax treatment of CLPs internationally for both direct and indirect tax from the perspective of the customer and the CLP provider. The findings revealed that although international jurisdictions such as Australia, Canada, New Zealand, the UK and the USA have made headway in taxing CLPs in direct response to their increased prevalence in the commercial environment, the tax provisions established and the administration thereof can be improved. While research has been done on the indirect tax (consumption tax levied on the supply of goods or services under a CLP), employee benefits tax (employees taxed on the value of CLP rewards received from employers) and income tax implications for the provider (sales revenue from the CLP transaction is fully included in the income of the provider) relating to CLPs in Australia, Canada, New Zealand, the UK, and the USA, it does not address the tax implications of CLPs in the hand of the customer (the rewards). Simply stated, the existing legislation focuses on taxing flight rewards and employee benefit rewards and is insufficient. Consequently, further research on the taxation of CLPs is necessary to contribute to this area of taxation. Therefore, using the findings of this study, South Africa has an opportunity to devise an effective, concise and administratively efficient tax reform for CLPs.

Keywords: Customer loyalty programmes, direct tax, indirect tax, loyalty, taxation

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

ABBREVIATIONS AND ACRONYMS

Table 1.1: Abbreviations and acronyms used in this document

Abbreviation	Name
ATO	Australian Tax Office
CIR	Commissioner of Inland Revenue
CLPs	Customer Loyalty Programmes
COT	Commissioner of Taxation
CPA	Consumer Protection Act No. 68 of 2008
CRA	Canada Revenue Agency
CSARS	Commissioner for the South African Revenue Services
FBTAA	Fringe Benefit Tax Assessment Act of 1986
FCT	Federal Commissioner of Taxation
GDP	Gross Domestic Product
GST	Goods and Services Tax
HMRC	Her Majesty's Revenue and Customs
IFRS	International Financial Reporting Standards
IN	Interpretation Note
IRS	Internal Revenue Service
ITAA	Income Tax Assessment Act
ITC	Income Tax Case
OECD	Organisation for Economic Co-operation and Development
RSA	Republic of South Africa
SA	South Africa
SARS	South African Revenue Services
SATC	South African Tax Cases
SCA	Supreme Court of Appeal
SIR	Secretary of Inland Revenue
The Act	Income Tax Act No 58 of 1962
UK	United Kingdom
UK Act	The Income Tax Act of 2007
UK VAT Act	The Value-Added Tax of 1994
US	United States
USA	United States of America
VAT	Value-Added Tax
VAT Act	Value-Added Tax No 89 of 1991

CHAPTER 1: INTRODUCTION

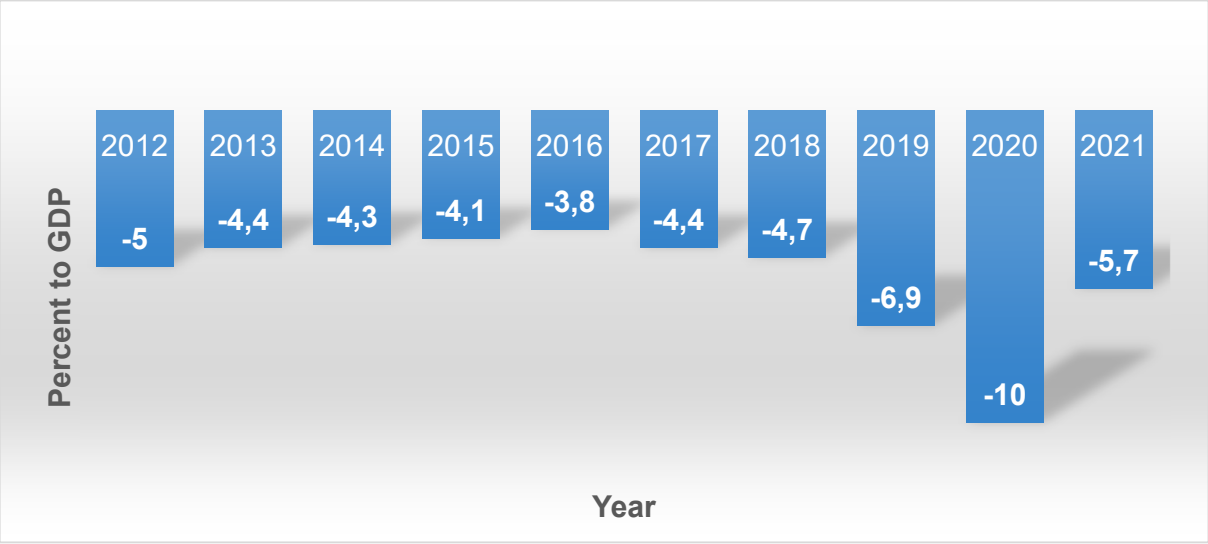
1.1 INTRODUCTION AND BACKROUND

Customer loyalty programmes (CLPs) are reward systems that provide rewards to customers to incentivise them to remain loyal to the business providing the CLP (Breugelmans, Bijmolt, Zhang, Basso, Dorotic, Kopalle, Minnema, Mijnlieff & Wünderlich, 2015:128; Pidduck, Odendaal, Kirsten, Pleace & De Winnaar, 2019:626; Swanepoel & Pidduck, 2020:76). These rewards can be either financial or non-financial rewards (Breugelmans *et al.*, 2015:129). Businesses also use CLPs because it allows them to track and influence customer decisions (Breugelmans *et al.*, 2015:128). In addition to the rewards they receive, customers use CLPs because it enhances and personalises their experiences, saves them time, and provides flexible and accessible purchasing and reward options (Burnstone & Olivier, 2018:4). As a result of the benefits for both businesses and customers, CLPs have become prevalent across a broad range of industries across the globe (Burnstone & Olivier, 2018:3; Pidduck *et al.*, 2019:626). In 2021 alone, CLPs were used by 74% of economically active South Africans, and it has increased in popularity in recent years (Cromhout, 2021:5).

The prevalence of CLPs is also indicative of a change in the nature of the economic transactions occurring between businesses and customers in South Africa. Interestingly, research indicates that there has been no change in how these transactions are taxed to correspond with the change in business (Odendaal & Pidduck, 2014:10; Pidduck & Odendaal, 2013a:1521; Pidduck *et al.*, 2019:627; Swanepoel & Pidduck, 2020:76-77). In general, the South African tax system provides tax revenue to fund the expenditure incurred by the South African government (National Treasury, 2021a:57). Therefore, the taxation of CLP rewards in the hands of customers should increase tax revenues in South Africa. Increasing tax revenues is critical as the South African government is in dire need of additional sources of tax revenue as they have consistently spent more than they have received in tax revenue in recent years (National Treasury, 2021b:10). Furthermore, it is acknowledged that the South African government needs additional tax revenue because of the damage caused by the COVID-19 pandemic, which has caused severe disruptions to economies over the world (National Treasury, 2021b:3).

According to the South African Revenue Services (SARS), the actual net collections represented a contraction of 7.8% in the 2020/21 fiscal year in comparison to the 2019/20 fiscal year, and the projected 2020/21 tax collection shortfall was expected to be the largest on record (National Treasury, 2021a:10; National Treasury, 2021b:3). This upsurge in government spending is expected to increase globally in the short term and the focus on tax revenues is inherently becoming even more important (OECD, 2021:5). Consequently, the public finances of South Africa are dangerously overstretched, and the borrowing requirement of the National Treasury is expected to remain above R500 billion per year in the medium term, leading the gross loan debt to increase from R3.95 trillion in the 2020/21 fiscal year to R5.2 trillion in 2023/24 (National Treasury, 2021a:9). The real gross domestic product (GDP) growth is projected to be 2.1% for 2022 (National Treasury, 2022:5). Figure 1.1 depicts the government deficit over time and indicates that it is a growing cause for concern for South Africa.

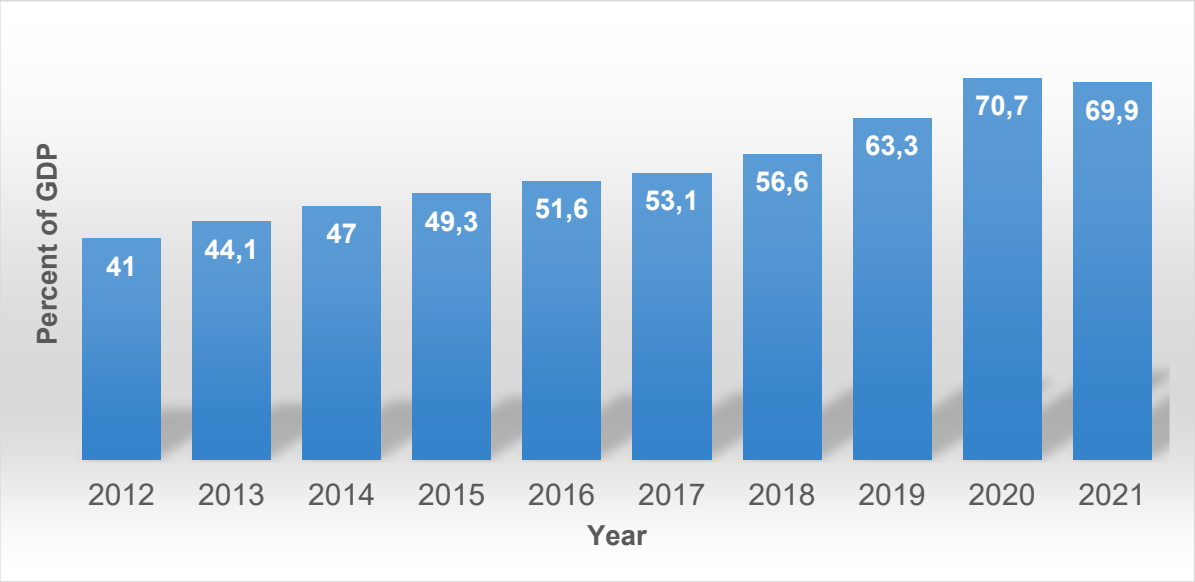
Figure 1.1: Government budget deficit



Source: Trading Economics (2022:1)

Moreover, the need for additional tax revenue is emphasised by the steadily growing government debt to GDP ratio as illustrated in Figure 1.2.

Figure 1.2: South African government debt to GDP



Source: Trading Economics (2022:1)

The review of the growth in the national debt in Figure 1.2 shows that the trend is expected to continue in the medium term, and the contractions in tax collections over the past years make it evident that the *fiscus* needs to collect additional revenue by expanding the tax base (National Treasury, 2021a:3). An increase in tax of up to R40 billion are needed to help stabilise public debt and return public finances to a sustainable portion over the four years following 2020 in order to get the economy running smoothly again (National Treasury, 2021a:39). Furthermore, the South African government should be wary of the continued reliance on borrowing as the 2021 debt to GDP ratio is reflected at 69.9%, but the European Union suggests a debt to GDP ratio at a maximum of 60% for member countries (European Commission, 2022). To help the *fiscus* reduce the South African government deficit and debt to GDP ratio, it has been identified that there is a portion of the existing tax base that is not taxed, namely CLP rewards.

In light of the concerns related to South Africa's government deficit, it has been identified that there are no specific guidelines on the income tax treatment of CLPs for either the customers or the businesses providing it (Brink, 2014; Swanepoel & Pidduck, 2020:98). In brief, South Africa's taxing legislation, the Income Tax Act No. 58 of 1962 (hereafter referred

to as the Act), in general provides for a deduction of expenditure for one party to a transaction and an inclusion in income for the other (Odendaal & Pidduck, 2014:7; Pidduck & Odendaal, 2013a:1524; Swanepoel & Pidduck, 2020:77). However, in the context of CLPs, two recent cases were considered by the judiciary in *Big G Restaurants (Pty) Limited v CSARS* (2020) 82 SATC 403 (CC) (hereafter referred to as the *Big G case*) and *Clicks Retailers (Pty) Ltd. v CSARS* (2021) 84 SATC 71 (CC) (hereafter referred to as the *Clicks case*). These two cases are kindred not only because they are two of the few tax cases to appear before the Constitutional Court of South Africa but also because they are two of the first cases to address the taxation of CLPs. Interestingly, while the taxpayers in these cases failed in their attempts to claim a deduction under section 24C of the Act (for future expenditure to be incurred in relation to their CLPs), they are still able to deduct expenditure incurred in respect of the CLPs under the general deduction formula envisaged in section 11(a) of the Act (Brink, 2014; Pidduck & Odendaal, 2013a:1526). Nevertheless, the corresponding rewards received by customers are not taxed, which indicates a disparity in the taxation of CLPs since providers can deduct expenditure incurred in respect of CLPs but the rewards are not taxed in the hands of the recipient (Odendaal & Pidduck, 2014:7; Pidduck & Odendaal, 2013a:1524; Pidduck *et al.*, 2019:627; Swanepoel & Pidduck, 2020:77).

Commentators argue that CLP rewards received by customers satisfy the gross income definition and should be included in a taxpayer's gross income (Odendaal & Pidduck, 2014:12; Pidduck & Odendaal, 2013a:1532; Pidduck *et al.*, 2019:638; Swanepoel & Pidduck, 2020:98). Consequently, the argument is made that by not taxing the receipt of CLP rewards in accordance with the gross income definition, the South African *fiscus* is losing much needed tax revenues. In quantifying the aforementioned estimated losses of tax revenues, (Odendaal & Pidduck, 2014:10-11) relied on the accounting disclosures presented in the annual financial statements of selected companies offering the CLPs. However, the values (deferred revenues) used in the studies were based on a now outdated reporting interpretation, namely the International Financial Reporting Interpretation Committee 13 (IFRIC 13).

In addition to quantifying the value of CLP rewards in an attempt to quantify possible tax revenues, prior research also considered various mechanisms to tax CLP rewards (Pidduck

et al., 2019). One mechanism that was considered is the inclusion of the CLP rewards into the income of individuals, similar to that of employment income, where the value of CLP rewards received by a customer will be recorded and pre-populated on the customer's individual tax return. This mechanism would allow the CLP reward income to be included in the calculation of the individual's taxable income to which the current progressive tax tables could be applied (Pidduck *et al.*, 2019:639). However, businesses would be required to provide customers with the necessary documentation each year to allow for CLP income to be included into their income and this would create an additional administrative burden for businesses (Pidduck *et al.*, 2019:639). This mechanism may also result in a higher tax liability for taxpayers upon the assessment of their tax returns due to the taxpayer being taxed at higher tax brackets than before and may be considered unfair by taxpayers (Pidduck *et al.*, 2019:639). In addition to this, customers who are sensitive to increases in expenditure and a tax on CLP rewards in this manner may undermine the essence of a CLP as customers may opt to not join the programmes (Pidduck & Odendaal, 2013a:1528). Therefore, this mechanism was rejected.

Consequently, Pidduck and Odendaal (2014; 2013a) proposed a flat rate of withholding tax to be applied to CLP rewards. The withholding tax proposed reduces the risk of a perceived additional tax burden by customers as they would receive the CLP reward after the deduction of the withholding tax, and therefore, would not be liable to pay additional tax upon submission of their tax returns (Pidduck & Odendaal, 2013a:1528). However, this mechanism did not consider the fundamental principles embraced in a progressive tax system in its attempt to broaden the tax base (Pidduck *et al.*, 2019:630). A fundamental principle of a progressive tax system is that a progressive tax rate results in greater tax revenue and decreases income inequality, where higher earning taxpayers pay a higher rate of tax and a lower tax rate is applied to lower earning taxpayers (Inchauste, Lustig, Purfield & Maboshe, 2015; Lebert, 2021:35).

Taxing CLP rewards through a mechanism that is fair and promotes equality in coherence to a progressive tax system will lead to increased revenue for the *fiscus.* Therefore, quantifying any tax revenues that could be collected on CLP rewards via a progressive withholding tax has become an important aspect to research because of the increase in the South African government's expenditure (Pidduck *et al.*, 2019:626). Moreover, the conflict

in the nature of CLPs as well as their corresponding tax consequences should be of high importance to the government because of the South African tax policy aiming to avoid tax loss (Pidduck & Odendaal, 2013a:1522). Whether the amount of tax revenue forgone by not taxing CLP rewards will justify the changes required to tax the rewards can only be further investigated after determining what the potential tax revenues are.

1.2 RATIONALE FOR THE STUDY

This study forms part of a larger study. The larger study aims to determine the potential tax revenue from a tax on CLP rewards. Quantifying this tax revenue may be determined if the administrative changes required to tax the CLP rewards are justified and may lead to further research into the feasibility of taxing CLP rewards with the goal of increasing revenue collections by the South African *fiscus.* The larger study focussed on quantifying the tax revenue on CLP rewards received by customers, relies on the disclosure presented in the annual financial statements of the various CLP providers selected for use.

The larger study uses the deferred revenue presented in the annual financial statements of the providers that offer CLPs. These financial statements have been prepared using International Financial Reporting Standard (IFRS) number 15, which requires companies to implement a five-step approach to recognise, measure and present revenue and deferred revenue received from a customer in a CLP transaction (International Accounting Standards Board, 2018). The five-step approach outlined in IFRS 15 allows the researchers in the larger study to quantify the tax revenues on CLP rewards with greater accuracy than before. In addition, a rate of tax needs to be applied to the deferred revenue values obtained from the financial statements in order to quantify the tax revenues on CLP rewards. Based on prior research, a recommendation for a progressive withholding tax was made (Pidduck *et al.*, 2019:641) because it allows large amounts of tax revenue to be collected quickly by receiving the tax directly when income is paid in the current year (Saptono & Aditama, 2022:109).

While the larger study aims to determine the potential tax revenue from the taxation of CLP rewards, the focus of the current study was to investigate the tax treatment of CLPs globally. The prior research that has been conducted in this area is limited to (Swanepoel & Pidduck, 2020:85) but provides an initial overview of the tax treatment of CLPs internationally.

However, (Swanepoel & Pidduck, 2020:97) reveals further avenues for research, including the necessity for further research in this area.

Prior comparative research is limited to an overview of the income and/or consumption tax implications of CLPs from the perspective of the customer. This study contributes by using a doctrinal research methodology to analyse the tax treatment of CLPs for both direct and indirect tax from the perspective of the customer and the CLP provider. Similarly, this study aimed to expose the mechanisms used to tax CLPs internationally. The findings of this study contribute to the body of knowledge in South Africa for the purpose of understanding how CLPs are treated from a tax perspective for comparative purposes and helps determine the progress that South Africa has made in establishing a national tax regime for CLPs.

1.3 RESEARCH PROBLEM

Substantial growth has been experienced in CLPs in South Africa over the past decade, and CLPs are used by over 74% of people who are economically active (Cromhout, 2021:5). However, there has been no change in the taxation of CLP rewards in the hands of the either the provider or the customer (Pidduck & Odendaal, 2013a:1521). For purposes of the larger study, research has been conducted to quantify the loss to the *fiscus* from CLP rewards in 2013, 2014 and 2019; however, this research, was conducted using the now superseded IFRIC 13 (Odendaal & Pidduck, 2014; Pidduck & Odendaal, 2013a; Pidduck *et al.*, 2019). IFRS 15 now provides mandated disclosure related to CLPs. These disclosures would facilitate quantification the tax revenues on CLP rewards in order to determine if the value of the tax revenues would outweigh any onerous legislative or administrative amendments and contribute towards the R40 billion that are needed to help stabilise public debt and public finances. Therefore, the larger study aims to quantify the potential tax revenues from the taxation of CLP rewards by customers. **The current study aimed to provide insight into the taxation of CLPs internationally from the perspective of the customer and provider in order to determine if there are lessons to be learned in respect to the taxation of CLPs in South Africa.**

1.4 RESEARCH QUESTION

The following research question are driving the larger study: How much potential tax revenues could the South African *fiscus* have received by taxing CLP rewards since the introduction of the relevant accounting disclosures?

The following research question was asked for the current study: **How are CLPs treated internationally from a tax perspective?**

1.5 RESEARCH OBJECTIVES

The following objectives were formulated to answer the research questions and achieve the goals of the larger study:

1. Define the characteristics of a CLP for the purposes of this study that would result in rewards potentially be subject to tax in the hands of the customers under the gross income definition in the Act.
2. Analyse the terms and conditions of the most widely used loyalty programmes in South Africa to determine whether they meet the defining characteristics of a CLP for the purposes of the study.
3. Analyse the annual financial statements of the providers of the selected CLPs in order to quantify the value of the CLP rewards issued to customers.
4. Quantify the cumulative potential tax revenues forgone by the South African fiscus as a result of not taxing CLP rewards.
5. **Compare the taxation of CLPs to other jurisdictions using authoritative literature.**
6. Analyse the terms and conditions of the most widely used CLPs in South Africa to determine whether they meet the defining characteristics of the charging section for the purposes of value-added tax (VAT) in South Africa.

They current study only focussed on the fifth objective. Therefore, the findings of this study contribute to that of the larger study and is limited in scope to objective 5. Like the larger study, the current study used qualitative methods to achieve the research objectives.

1.6 RESEARCH DESIGN AND METHODOLOGY

The larger study follows a qualitative research paradigm by using multiple longitudinal instrumental case studies (Creswell & Creswell, 2018:13-14; Yin, 2018:51). This study, which focussed on research objective 5 from the larger study, also followed a qualitative research paradigm but did not require the use of case studies in its design to answer the research question. Qualitative research is based on individuals constructing a meaning through interacting with their world (Merriam & Grenier, 2019:3). Qualitative research methods are used to provide an in-depth understanding of the research problem of the larger study and it is useful to explore new topics or understand complex issues (Hennink, Hutter & Bailey, 2020:29). Additionally, it involves the collection of data and its analysis to allow the researcher to interpret the meaning behind the data (Creswell & Creswell, 2018:4).

The current study used the doctrinal legal research methodology, which is defined as an investigation of laws and legislation (Duncan & Hutchinson, 2012:85). Doctrinal research involves the analysis of secondary data in the form of existing statutes and other regulatory material in the construction of a body of knowledge pertaining to a specific subject matter (Kharel, 2018:1; McKerchar, 2008:18). In its essence, doctrinal research is predominantly founded on jurisprudence and aims to unearth the quintessence of the laws as opposed to research that is superficial in nature (Chynoweth, 2008:30; Kharel, 2018:2; Singhal & Malik, 2012:1). Doctrinal research is commonly referred to ‘black-letter methodology’ because of its analysis of laws and legal provisions that are written in letters as opposed to an analysis of the operation of the law. The objectives of doctrinal legal research include, but are not limited to, the following:

- The development of new legal postulates and doctrines with the aim of introducing them to the already existing legal body of knowledge (Kharel, 2018:6); and
- Granting legal scholars the instruments required to conclude on a subject matter that is prone to great contention (Razak, 2009:19).

The principal purpose of doctrinal legal research is to enhance laws and legislation in a manner that has the potential to achieve the optimum objective of law (Kharel, 2018:6). The use of doctrinal research for the current study was apt as this study aimed to analyse the legislation, doctrines, case law and legal data of selected jurisdictions as it pertains to CLPs.

The study provides an international perspective which helped answer the research question specific to this study in order to understand how CLPs are treated internationally from a tax perspective. Therefore, doctrinal legal research was an appropriate tool to achieve the objective of providing insight into and an international perspective on the tax treatment of CLPs.

1.6.1 VALIDITY, RELIABILITY, AND OBJECTIVITY OF THE STUDY

There is a certain amount of subjectivity and prejudice that arises in doctrinal research as the researcher interprets and analyses legislation for the study (Bhandari, 2020:1). Objectivity and integrity should be continuously maintained throughout the performance of a study (Mouton, 2001:240). Through the performance of the study, the effect of error through bias or subjectivity should be minimalised to enhance the validity of the study and the conclusion based on the research performed (Mouton, 2001:110). It is accepted that the perspectives and experience of the researcher may influence the study and affect the reliability of the study (Patton, 2002:566).

The following steps were taken throughout the performance of this study to enhance and maintain the validity, reliability and objectivity of this study:

- The researchers in the larger study and the current study collaborated on the research proposal and actively engaged one another in critical thinking and professional scepticism to limit personal bias or subjectivity from affecting the study.
- Due to the subjectivity and bias that exists in interpreting legislation, the correct interpretation of the legislation is critical to successfully apply the legal doctrine to the facts of the case (Pidduck, 2019:211). Therefore, critical and comprehensive analysis of authoritative literature, such as legislation, case law and statutes, were conducted in order to analyse the tax treatment of CLPs.
- Additionally, there was a risk of using unreliable sources to obtain literature such as statutes, legislation and case law that were required to conduct the doctrinal legal research. In order to ensure that factual and accurate literature was used in the research, the legal documents were selected from reliable and impartial sources, such as the Canada Revenue Agency (CRA) website of the Canadian government, the New Zealand Inland Revenue website of the New Zealand government, the

Internal Revenue Service (IRS) website of the US government, the Australian Tax Office (ATO) website of the Australian government, and Her Majesty's Revenue and Customs (HMRC) website of the UK government.

- The final area that raised concerns of validity and reliability was whether the analysed literature was adequate to constitute a holistic analysis of the complete tax treatment of CLPs in international jurisdictions. To address this issue, the sources mentioned above were thoroughly scrutinised and explored in order to ensure that the tax regime regarding CLPs was analysed in its entirety for the purposes of this study.

1.6.2 SELECTION OF JURISDICTIONS FOR ANALYSIS

For purposes of this study it was necessary to select jurisdictions for analysis in order to maintain a feasible scope for the research activities, as suggested by Pidduck (2017:7) and Pidduck (2019:209). South Africa is the primary jurisdiction for the study as the writer is a resident in South Africa and has in-depth knowledge of South African tax legislation. The remaining jurisdictions selected for purposes of this study were Australia, Canada, New Zealand, the UK and the USA. The reasons for the selection of these jurisdictions are explained below.

South Africa is a member of the Commonwealth Nations (The Commonwealth, 2022:1). The Commonwealth is an alliance between 54 countries that aims to achieve law and order, democracy and prosperity in the respective countries (The Commonwealth, 2022:1). According to the United Nations (2022), laws and statutes are essential tools in achieving peace, prosperity and democracy within a country. Therefore, since the South African legal system is influenced by Dutch and English (Roman Dutch and common law) legal principles and since Australia, Canada, New Zealand and the UK form part of the Commonwealth and have legal systems based on English common law, these jurisdictions are comparable to South Africa for purposes of this study due to their shared commonwealth and common law origin (Rishworth, 2016:136; The Commonwealth, 2022:1).

In addition, the legal principles of the USA are based, in part, on common law. Furthermore, the USA and South Africa have entered into a strategic partnership that aims to improve trade and the economy in both countries (United States Embassy and Consulates in South Africa, 2022:1). Therefore, it can be reasonably expected that the laws of both South Africa

and the USA reflect common interests for both countries. Therefore, the USA was included as a jurisdiction for comparison for this study.

1.6.3 SCOPE LIMITATIONS OF THE STUDY

This study sought to determine how CLPs are treated internationally from a tax perspective for comparison to South Africa. The limitations on the scope of the study are outlined below:

- The study is based on the jurisdictions selected for comparison (section 1.6.2). Therefore, any conclusions made may not be applicable to other jurisdictions where similar circumstances or CLPs do not exist.
- The policies and operations of CLPs differ between organisations and between countries. Additionally, tax statutes and principles differ between jurisdictions. Therefore, this study is based solely on the tax principles applicable to CLPs in the respective jurisdictions and the taxable nature of CLPs based on their respective operations and policies.
- As only a limited number of jurisdictions were analysed, it is not feasible to generalise the findings regarding the tax treatment of CLPs globally.
- The study does not claim to prescribe a final tax treatment for the taxing of CLP rewards in South Africa but rather to provide a basis for the potential tax regime that may be established by the South African taxing authority using lessons from international jurisdictions.
- The current study and the larger study did not consider the behavioural changes of the affected customers and businesses that may occur as a result of the implementation of taxation on CLP rewards.

1.7 STRUCTURE OF THE MINI-DISSERTATION

The chapters of the current study are structured as follows:

- **Chapter 1: Introduction and Background.** Chapter 1 outlines the comprehensive background of the research topic, research objectives, problem and questions of the larger study as well as the current study. The chapter further discusses the research design and methodology adopted in this study as well as the rationale behind the selection of the jurisdictions under review.

- **Chapter 2: Customer Loyalty Programmes in South Africa.** Chapter 2 analyses authoritative literature in order to provide an understanding of the direct and indirect taxation of CLPs in the South African context from the perspective of both the provider and the customer. The literature includes a critical analysis of the most recent prominent cases of *Big G* and *Clicks* from the perspective of the provider. Furthermore, literature related to proposals for taxation of CLP rewards in the hands of the customer in South Africa and mechanisms to do so are included.
- **Chapter 3: Tax Treatment of Customer Loyalty Programmes Internationally.** Chapter 3 analyses the tax implications associated with CLPs in the selected tax jurisdictions, namely Australia, Canada, the UK, New Zealand and the USA. The analysis encompasses all categories of taxes in the respective jurisdictions and is summarised in a comparative table at the end of the chapter to compare with that of South Africa.
- **Chapter 4: Conclusion and Recommendations.** Chapter 4 provides a conclusion to the study and summarises all the findings of the research. Furthermore, the chapter makes recommendations for similar future research studies.

CHAPTER 2: CUSTOMER LOYALTY PROGRAMMES IN SOUTH AFRICA

2.1 INTRODUCTION

Chapter 1 introduced the context of CLPs in South Africa, the rationale, research questions and objectives as well as the research methodology followed in the current study. While the objective of this study is to compare the taxation of CLPs of other jurisdictions using authoritative literature, it is critical to first obtain an understanding of the operation of CLPs in South Africa and the related tax implications. In order to achieve the research objective, a thorough understanding of the South African context is required to understand the direct and indirect taxation of CLPs from the perspective of both the provider and the customer. The literature analysed in this chapter includes a critical analysis of the most recent prominent cases of *Big G* and *Clicks* from the perspective of the provider. Literature related to proposals for taxation of CLP rewards in the hands of the customer in South Africa and mechanisms to do so is also discussed.

2.2 OPERATION OF CLPs

In order to understand how CLPs operate, it is necessary to understand what CLPs are. CLPs are designed by companies to provide customers with financial and non-financial benefits for remaining loyal to the company (Odendaal & Pidduck, 2014:6). Brink (2014:5) confirms that CLPs are available to the public and allow customers to accumulate benefits after making a purchase. Customers may thereafter decide to use these accumulated benefits to either receive goods or services or to receive a discount on any future purchase of goods or services (Brink, 2014:5). Olivier and Burnstone (2014:3) categorise CLPs into two main types, namely rewards programmes and customer clubs. These two types can be defined as follows:

- Rewards programmes encourage specific consumer behaviour and reward customers in the process. Customers are rewarded in the form of either a discount on a current transaction, an allocation of loyalty points that can be redeemed on a future transaction, or a reward that can be used to purchase products and services from third parties (Olivier & Burnstone, 2014:3).

- Customer clubs offer a range of benefits to members, typically charge a membership fee, and do not reward members for specific transactional behaviours but instead provide members with “retail discounts and/or value-added benefits” (Olivier & Burnstone, 2014:3).

The Consumer Protection Act No. 68 of 2008 (hereafter referred to as the CPA) defines a loyalty programme as follows:

> “Any arrangement or scheme in the ordinary course of business, in terms of which a supplier of goods or services … offers or grants to a consumer any loyalty credit or award in connection with a transaction or an agreement.”

The CPA also distinguishes between trade coupons and similar promotions and customer loyalty programmes, whereby CLPs are considered a legal medium of exchange, but trade coupons and similar promotions (discounts) are not seen as a medium of exchange. Chun, Iancu and Trichakis (2020) describe CLP rewards as a “new form of currency”. This description coincides with the CPA’s consideration of CLPs (other than coupons and discounts) as a legal medium of exchange. CLP rewards earned by a customer can be used to procure some or other benefit for the customer in a similar way to how the customer would use monetary bank notes to procure goods or services for themselves. Although CLP rewards are not monetary bank notes and do not have physical substance, they can be used as a legal medium of exchange and by virtue of the fact that they exist solely in an electronic sphere (the provider’s database, CLP cards, apps, etc.), they can thus be classified as electronic mediums of exchange, that is electronic currency.

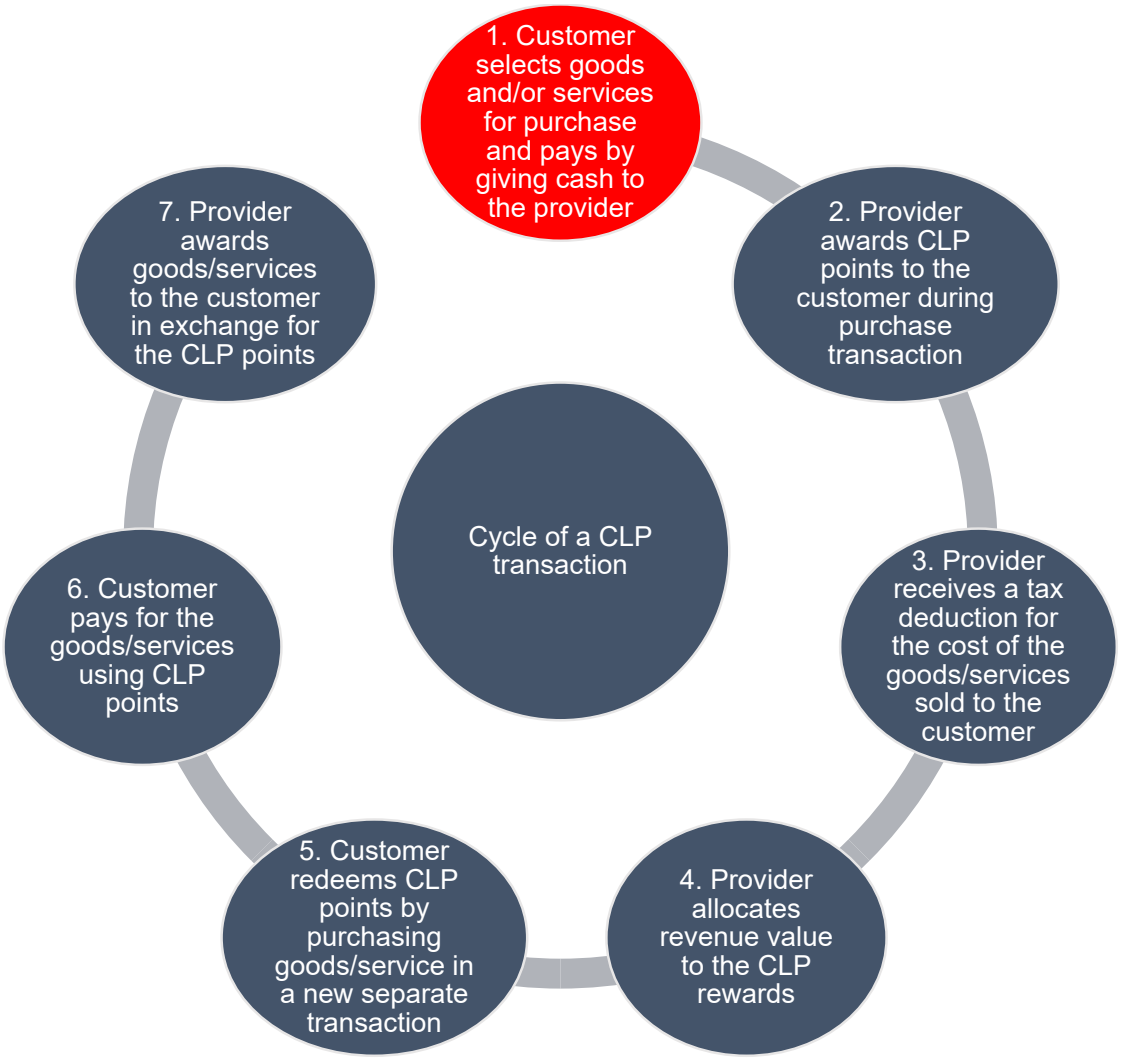
SARS defines CLPs as follows:

> “Incentive schemes used by businesses such as retailers or banks to encourage sales by offering rewards with the intention of attracting new customers as well as retaining their respective customer bases.” (South African Revenue Service Interpretation Note 118, 2021:3)

The CLP is driven by a relationship and a contract between the customer and the CLP provider. The provider is a company and the customer may be any natural or juristic person with contracting capacity. The customer and the provider enter into a contract where the customer agrees to receive various CLP benefits when buying goods or services from the

provider in exchange for providing the provider with their personal information and being entered into the provider's CLP database (Ailawadi, Bradlow, Draganska, Nijs, Rooderkerk, Sudhir, Wilbur & Zhang, 2010:281). Both parties benefit from the transactions. The provider of the CLP receive loyalty from the customer, increased sales income from the customer in future (due to the loyalty), and incur less costs to market their products and services to the customer due to being able to directly market and advertise their products and services to the customer using the personal information obtained when the contract was entered into by both parties (Chaudhuri, Voorhees & Beck, 2019:4; Meyer-Waarden, 2015:22; Viswanathan, Sese & Krafft, 2017:901). Conversely, the customer also benefits by obtaining free goods or services, discounts on purchases, or even cash rewards (Breugelmans *et al.*, 2015; Kwiatek & Thanasi-Boce, 2019). Figure 2.1 is an illustration of a basic cycle of a CLP transaction in South Africa.

Figure 2.1: Cycle of basic CLP transaction

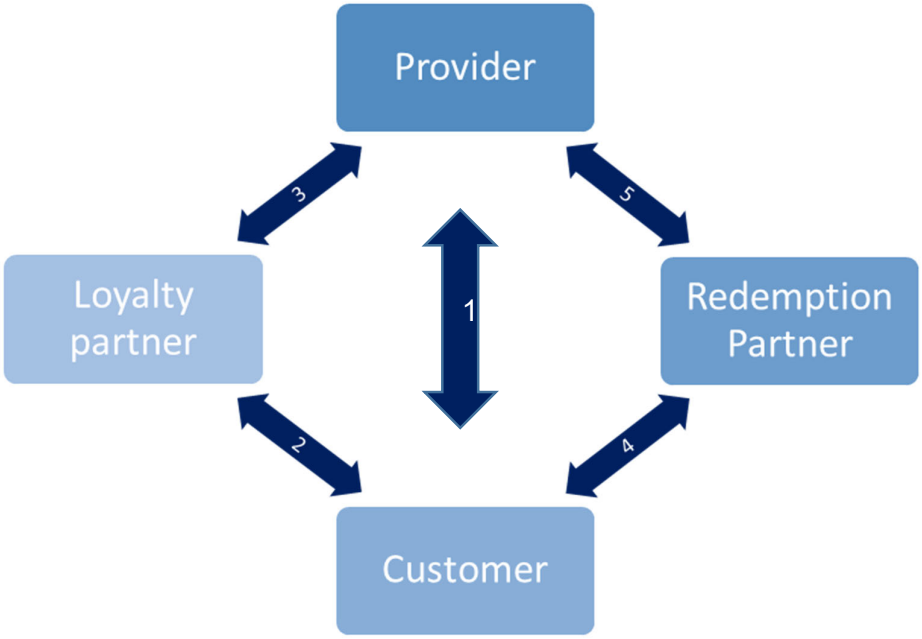


Source: Author's own design

Some CLP transactions are more complex than that depicted in Figure 2.1 because they are tripartite or quadripartite and involve the purchase or awarding of goods or services or CLP benefits between more than one party (South African Revenue Service Interpretation Note 118, 2021:5). In these CLPs, customers may be able to earn or redeem CLP points from an entity that is not the provider of the CLP, as is the case with CLPs such as ABSA Rewards, Discovery Vitality, FNB eBucks, and Ster-Kinekor SK Club (Absa Bank Limited, 2022; Discovery Limited, 2022; FirstRand Bank Limited, 2021; Ster-Kinekor Theatres (Pty)

Limited, Not dated). Such an entity is referred to as a loyalty or redemption partner. Figure 2.2 illustrates a more complex CLP transaction in South Africa involving more than two parties.

Figure 2.2: Cycle of a complex CLP transaction



Source: (South African Revenue Service Interpretation Note 118, 2021:5)

The numbers illustrated in Figure 2.2 represent the flow of a CLP transaction involving loyalty and redemption partners. Such a CLP transaction flows as follows:

1. The CLP provider and the customer enter into a CLP contract.
2. Under the CLP contract, the customer transacts with a loyalty partner of the CLP to purchase goods or services from the loyalty partner in exchange for cash consideration. In addition to the goods or services, the customer earns rewards or points of the provider's CLP from the loyalty partner.
3. The loyalty partner pays the CLP provider a points fee in terms of their agreement
4. The customer redeems the CLP rewards or points from the redemption partner of the CLP. The redemption partner collects the CLP rewards or points from the customer and grants the goods or services acquired with the rewards or points.
5. The provider pays the redemption partner a redemption fee in terms of their agreement

2.3 CLPs IN THE SOUTH AFRICAN CONTEXT

CLPs entered the South African landscape and had already garnered R12 billion annual revenue and more than 10 million customers by 2013 (Trade Conference International, 2013). The growth in the demand for CLPs has led to multiple industries introducing and operating CLPs (Globe Newswire (2022). CLPs are primarily operated in the airline, financial services, retail, business to business, leisure and wellness industries (Globe Newswire, 2022). According to Cromhout (2021:7), approximately 74% of South African consumers are members of at least one CLP in South Africa. Further, CLPs have averaged an annual growth rate of 13,9% between 2017 and 2021, are expected to maintain the growth rate, and ultimately, achieve a US$512.9 million (approximately R8.734 billion) market capitalisation in 2022 (Globe Newswire, 2022).

It is imperative that CLPs be classified and grouped into a single category in order to be able to apply a uniform set of rules to all the CLPs. Although South African CLPs operate as shown in Figure 2.1 and 2.2, they are not homogenous and offer different rewards to their customers, including cashback, discount vouchers, travel/flight discounts, free gifts or sample goods, double points, birthday offers, ability to donate to charity (Cromhout, 2021:26). The differences in the rewards offered by CLPs to their customers coupled with the fact that all CLPs have different features makes it more difficult to classify and group all CLPs and apply a fixed set of rules on them. South African CLPs have the following varying features:

- CLPs such as Pick n Pay Smart Shopper and Makro Mcard rewards have a mobile cellular application specifically dedicated to their CLPs, and CLPs such as Shoprite Xtra rewards, DSTV rewards, MySchool MyVillage MyPlanet rewards and FNB eBucks do not have a dedicated application for their CLPs. However, some CLP providers have made provisions for some sort of mobile/cellular interaction with their customers; for example, Shoprite Xtra rewards have a WhatsApp line dedicated to their rewards customers and FNB eBucks has a feature on their normal banking app that is dedicated to their eBucks rewards customers (FirstRand Bank Limited, 2021; Masstores (Pty) Limited, Not dated; MultiChoice (Pty) Limited, 2020; Pick n Pay Stores Limited, 2022; Shoprite Holdings Limited, 2021; Virtual Market Place (Pty) Ltd, 2021).

- ABSA Rewards, Ster-Kinekor rewards, FNB eBucks and Discovery Vitality rewards are the prominent CLPs that have a complex CLP structure involving loyalty and redemption partners. Other CLPs such as Exclusive Books Fanatics and Edcon rewards have a more basic structure with no partners where customers only transact with the CLP provider (Absa Bank Limited, 2022; Discovery Limited, 2022; Exclusive Books Group (Pty) Limited, 2022; FirstRand Bank Limited, 2021; Retailability (Pty) Limited, 2022; Ster-Kinekor Theatres (Pty) Limited, Not dated).
- Six of the CLPs listed in Cromhout (2021:15) top 25 allow customers to donate the CLP rewards they have earned to charitable organisations, namely Pick n Pay Smart Shopper, Nedbank Greenbacks, Dis-Chem rewards, Standard Ucount, ABSA Rewards, FNB eBucks and MySchool MyVillage MyPlanet rewards (Absa Bank Limited, 2022; Dis-Chem Pharmacies Limited, Not dated; FirstRand Bank Limited, 2021; Nedbank Limited, 2021; Pick n Pay Stores Limited, 2022; Standard Bank Group Limited, 2022; Virtual Market Place (Pty) Ltd, 2021).
- CLP rewards vary and may consist of immediate shopping discounts, as is the case with Shoprite Xtra rewards and Woolworths WREwards; earning shopping points to use in the future, as is the case with the Foschini Group rewards, Dis-Chem rewards and Clicks ClubCard; or non-financial rewards, such as Discovery Vitality (Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; Discovery Limited, 2022; Foschini Retail Group (Pty) Limited, Not dated; Shoprite Holdings Limited, 2021; Woolworths Holdings Limited, 2021).
- Many CLPs in South Africa, such as The Foschini Group's TFG rewards, Edcon Ltd.'s ThankU rewards, Exclusive Books' Fanatics rewards, Clicks ClubCard and SPAR Rewards, award a membership card with a unique serial to the member and grant the member the right to use that card to accumulate rewards or points in the CLP (Exclusive Books Group (Pty) Limited, 2022; Foschini Retail Group (Pty) Limited, Not dated; Odendaal & Pidduck, 2014:9; Retailability (Pty) Limited, 2022). Included in the terms and conditions of these CLPs is a clause that grants the CLP provider the right to revoke the membership card associated with the CLP and/or cancel the CLP membership of the customer for whatever reason the provider deems fit (Exclusive Books Group (Pty) Limited, 2022:1; Foschini Retail Group (Pty) Limited, Not dated; Retailability (Pty) Limited, 2022:1). This means the provider remains the rightful

owner of the CLP card even while the card is in the possession of the customer (Swanepoel & Pidduck, 2020:91).

- Different CLPs use different earning ratios. For example, FNB eBucks customers earn 1 eBuck for every R10 spent transacting with FNB on the FNB application or with a loyalty partner; Pick n Pay Smart Shopper awards one point for every R2 spent by a CLP customer; the Clicks ClubCard allows customers to earn points that are seen as a cashback reward where every R5 spent equates to 1 point; and the Dis-Chem rewards allow customers to earn points when shopping at Dis-Chem where 1.5% of the purchase value is converted into rewards on qualifying purchases (Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; FirstRand Bank Limited, 2021; Pick n Pay Stores Limited, 2022).
- Different CLPs use different point-to-Rand conversion ratios. Under the FNB eBucks, 10 eBucks points equal R1; 100 Smart Shopper points equal R1; 10 Clicks ClubCard points equate to R1; and 1 Dis-Chem rewards point equals R1 (Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; FirstRand Bank Limited, 2021; Pick n Pay Stores Limited, 2022).
- The rewards earned under the various CLPs have different expiry dates. While Pick n Pay Smart Shopper, Clicks ClubCard and Dis-Chem rewards points are all valid for 12 months from the date they are earned, Standard Bank Ucount rewards points remain valid for five years from the date they are awarded to customers. Furthermore, points earned under the Exclusive Books Fanatics CLP do not expire and are carried over to every new year (Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; Exclusive Books Group (Pty) Limited, 2022; Pick n Pay Stores Limited, 2022; Standard Bank Group Limited, 2022).

It can be concluded that CLPs are multi-faceted and cannot be definitively classified as a marketing tool, discount programme or currency as each are used differently by the providers (Odendaal & Pidduck, 2014:4). Therefore, it is important to examine legislation specific to South Africa, such as the CPA and other authoritative literature in order to obtain an understanding of the definition and classification of CLPs applicable in the South African context. Now that it has been established what CLPs are and how they operate, the current

tax treatment of CLPs in South Africa for both the provider and the customer is relevant. The following section looks at the tax treatment of CLPs from the perspective of the provider.

2.4 GENERAL DEDUCTION DISCUSSION

CLP providers claim income tax allowances and deduct expenditure incurred when calculating their taxable income for a year. The Act does not make provisions for providers to be able to claim allowances that specifically relate to CLPs. However, as shown in point 3 of Figure 2.3 (section 2.2), the provider may currently deduct expenditure incurred using section 11(a) and 23(g) of the Act, which is commonly referred to as the 'general deduction formula'. The provider must satisfy all the elements of the general deductions formula to be able to deduct expenses incurred in their CLP. Section 11(a) states the following:

> "For the purposes of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature."

Conversely, section 23(g) is a prohibition section and states the following:

> "No deductions shall in any case be made in respect of the following matters, namely any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade."

Since the provider of the CLP incurs a cost to acquire the goods or services that are sold to the customer in a CLP transaction, an analysis is required to determine whether these costs satisfy all the elements of the general deduction formula. The individual components of the general deduction formula are discussed and applied to CLP providers in the following subsections.

2.4.1 CARRYING ON A TRADE

The first requirement of the general deduction formula is that the taxpayer must be carrying on a trade. The Act does not provide a definition for the term 'carrying on a trade'. Furthermore, seminal case law has not devised a definitive definition for the term, although

they have established a set of tests that can be applied to each case to determine whether the taxpayer is carrying on a trade. However, according to (Collins, Not dated) to 'carry on' implies a level of continuity. The providers in CLPs are currently and continuously operating their businesses. The CLPs would not be operating if the providers were not operating their businesses on a continual basis. Section 1 of the Act defines the word 'trade' as follows

> "Every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature."

In *Burgess v CIR* (1993) (4) SA 161 (AD), it was held that the definition of trade provided in section 1 of the Act should not be considered an exhaustive list of the different kinds of trade but that the word 'trade' should be given a wider interpretation. Nevertheless, *Burgess v CIR* together with *ITC No 1275* (1978) 40 SATC 197 and SARS IN 33 (2017:4) established that an action or performance that produces any form of passive income, namely interest income, dividend income, pension and annuity receipts, is not included in the definition of 'trade'. CLP providers operate businesses of buying and selling goods or rendering services for a consideration with the aim of making a profit. Further, the source of the income earned by CLP providers is from customers and does not constitute a passive income. Therefore, since a 'business' is included in the definition of a trade and revenue from customers is not passive income, it can be concluded that the business of CLP providers is a trade as defined.

In addition to the above, the activities concerned should be examined as a whole to establish whether the taxpayer is in fact carrying on a trade *(Estate G v COT* (1964) 26 SATC 168 (SR)). A primary characteristic of a CLP is a provider selling goods or services to a customer on favourable terms for both parties. Therefore, selling goods or services to customers and operating a CLP form part of the business that the CLP provider is conducting and may constitute the 'carrying on of a trade'. Furthermore, in *Stephan v CIR* (1919) 32 SATC 54 (WLD) a single venture was held to be the 'carrying on of a business'. Regardless of whether the provider has other business ventures in addition to the CLP or separate sales of goods or services to customers, the provider will still be considered to be carrying on a business or a trade. Therefore, if the entirety of the provider's sales to customer are solely structured

around and involve the CLP, then that structure represents the 'activity' that needs to be analysed as a whole in order to determine if the provider is considered to be carrying on a trade as envisaged in *Estate G v COT*.

Additionally, in *De Beers Holdings (Pty) Ltd. v CIR* (1985) 47 SATC 229 (AD) and the *Modderfontein Deep Levels Ltd. v Feinstein* (1920) 288 (TPD) it was held that taxpayers may often be forced to sell at a loss and that 'trade' does not have to be a profitable activity. Therefore, if a customer's redemption of their CLP rewards results in the provider not recognising a profit on the transaction, the provider's business will still be a trade. The provider does not need to be a profit-making 'trader'. Therefore, a CLP provider that may solely be running an operation structured around the CLP and not party to any other sales transactions that do not involve the CLP and that may be making a loss will still be considered a taxpayer that is carrying on a trade.

Based on this analysis, it can be concluded that providers of CLPs are 'carrying on a trade' because not only do they have a business (a trade) of buying and selling goods or services, but there is an element of continuity in the operation of the CLPs they operate.

2.4.2 EXPENDITURE OR LOSSES

The Act does not provide definitions for the words 'expenditure' and 'loss', and therefore, seminal case law will be used to assign meaning to the words. In *Joffe & Co (Pty) Ltd. v CIR* (1946) 13 SATC 354 (AD) it was held that an expenditure or cost was voluntarily incurred whereas a loss is involuntarily suffered. Providers that operate CLPs are not forced to purchase goods that they sell in their businesses (or enter into CLP agreements), but rather, they voluntarily choose to incur these costs in order to operate their businesses. Therefore, the costs incurred by a CLP provider are considered an 'expenditure' and not a loss.

In addition to the above, *CSARS v Labat Africa Ltd.* (2012) 74 SATC 1 (SCA) and *ITC No 1783* (2004) 66 SATC 373 established that any costs paid for through the issue of the payer's (company) equity shares is not 'expenditure' and the words 'obligation', 'liability' and 'expenditure' are not synonymous or substitute each other. The meaning of expenditure refers to the act of spending funds or money. It can thus be concluded that the costs incurred by CLP providers are regarded as 'expenditure' for the purposes of section 11(a) insofar as

the costs are not settled through issuing or allotting equity shares of the provider to the supplier of the goods or services.

2.4.3 ACTUALLY INCURRED

Although an expenditure incurred could be excessive, the issue is not of whether the expenditure was ‘necessarily’ incurred, but rather, whether it was ‘actually’ incurred (*Port Elizabeth Electric Tramway Co Ltd. v CIR* (1936) 8 SATC 13 (CPD)). Therefore, if the provider incurs an expenditure to acquire operational goods or services at a cost that exceeds the market value of the goods or services (is excessive), that expenditure can still be actually incurred and deductible under section 11(a).

Furthermore, *CIR v Edgars Stores* Ltd. (1986) 48 SATC 89 (T) notes that the presence of an unconditional legal obligation to pay for an expense is pivotal in order for the expenditure to be ‘actually incurred’. When CLP providers enter into a purchase agreement or contract with the supplier (to settle an obligation to a CLP customer for example), the provider will only be unconditionally obligated to pay the supplier once two occurrences happen, namely the supplier has performed in terms of the purchase contract and has delivered the goods or services to the provider, and there is no outstanding condition as stipulated in the contract that still needs to be satisfied by either the supplier or the provider

In addition to the above in *Caltex Oil (SA) Ltd v SIR* (1975) 37 SATC 1 (A) it was held that expenditure actually ‘incurred’ does not mean expenditure actually ‘paid’ during the year of assessment. Therefore, the CLP provider can incur costs to acquire goods or services without paying for the costs. Conversely, a pre-payment for the costs does not mean the costs have been incurred by the provider.

In conclusion, the costs incurred by a CLP provider to acquire the goods or services sold to customers under a CLP will be considered an expenditure that has actually been incurred once the provider and the supplier of the goods or services have performed all their duties outlined and have satisfied all conditions in the purchase transaction. The duties comprise of delivery of the goods or services by the supplier and the acknowledgement of the obligation to pay by the provider. Furthermore, the expenditure will be considered to be actually incurred regardless of whether the costs are excessive or not and regardless of

whether the provider has paid for the goods or services and settled their obligation with the supplier.

2.4.4 DURING THE YEAR OF ASSESSMENT

Expenditure is only deductible in the year of assessment in which it is actually incurred *(Concentra (Pty) Ltd. v CIR* (1942) 12 SATC 95 (CPD)). The costs incurred by a CLP provider will only be deductible in the year in which all the conditions under the purchase agreement with the supplier have been satisfied. That is to say that the supplier has delivered the goods or services and the provider has paid for the supply or accepted the contractual liability to pay the supplier at a later stage and no other contractual terms or conditions are still pending at the end of the year. This element is contingent on the above element of 'actually' incurred being satisfied and proceeds to affix a time as to when the 'actually incurred' element was satisfied.

2.4.5 IN THE PRODUCTION OF INCOME

Income is defined as gross income less the exempt income by section 1 of the Act. Further, section 23(f) of the Act prohibits the deduction of expenditure incurred in respect of any amounts received or accrued that are not 'income' as defined. Income earned by CLP provider from sales to CLP customers sales is generally not exempt under any section of the Act and would therefore be considered income for purposes of the general deduction formula. Therefore, the expenditure incurred for purposes of satisfying obligations to CLP customers would be considered in the production of 'income' as defined.

In addition to the above, *Port Elizabeth Electric Tramway Co Ltd v CIR* (1936) 8 SATC 13 (CPD) and *Joffe & Co (Pty) Ltd v CIR* (1946) 13 SATC 354 (AD) (at 359) established that the following two questions must be answered to determine whether or not the expenditure is in the production of income: "To determine whether the act to which the expenditure was related, was to produce income, and was the expenditure linked closely enough to the act?"

In the case of CLPs, the action and purpose of the expenditure incurred to acquire goods or services is the obligation to CLP customers as part of its business operations under the CLP contract. This expenditure is closely connected to the income-earning activities of the provider. The provider has to sell those goods or service in order to generate an income.

Similarly, *Joffe & Co (Pty) Ltd. v CIR* and *CIR v Golden Dumps (Pty) Ltd.* (1993) 55 SATC 198 (A) held that the expenditure needs to be "part and parcel" to operating the trade and unavoidable. It is submitted that due to changes in industries, CLPs have become common practice and had the provider not offered CLPs or incurred these expenditures, the CLP customer income would not have been generated. Therefore, the expenditure incurred by the provider under the CLP is an unavoidable cost of the business.

In conclusion, the expenditure incurred under a CLP to acquire goods or services will be in the production of income as it is not for purposes of generating exempt income, it is closely connected to the income-earning activities, and it is an unavoidable cost of the business.

2.4.6 NOT OF A CAPITAL NATURE

Expenditure that is considered capital in nature will not be deductible under the general deduction formula and expenditure that is revenue in nature will be deductible. To determine the purpose of the expenditure, the facts of each case must be analysed. Case law provides the following guidance to distinguish between the two:

- Enduring benefits. Expenditure that creates an 'enduring (long-term) benefit' for the trade is considered to be capital in nature, and the converse is also true. An enduring benefit can only be produced by an income-earning structure (*Rand Mines (Mining & Services) Ltd. v CIR* (1997) 59 SATC 85 (A); *BP Southern Africa (Pty) Ltd. v C:SARS* (2007) 69 SATC 79 (SCA)). The expenditure incurred by CLP providers is not incurred to acquire an affixed income-earning structure but rather to acquire goods or services that will ensure continuity in operations by earning revenue. The benefit obtained by the provider from the goods or services is, short term, a period cost and does not create a benefit lasting longer than a year. Therefore, the expenditure is not of a capital nature and is rather revenue in nature and could be eligible for a deduction under section 11(a) of the Act.
- Income-earning operations. It must be determined whether the expenditure relates to trade 'operations or structure'. Structure means the expenditure is capital in nature and operations means the expenditure is revenue in nature (*SIR v Cadac Engineering Works (Pty) Ltd.* (1965) 27 SATC 61 (A)). The expenditure incurred by the provider relates to goods or services that are sold to customer on a regular and operational

basis. The expenditure does not form or enhance an income-earning structure in any way, and therefore, the expenditure relates more to the income-earning operations of the provider and are revenue in nature.

- Fixed and floating capital. It must be determined whether the expenditure relates to 'fixed or floating capital'. Fixed capital means long-term physical assets and the expenditure incurred to acquire such assets is capital in nature. Floating capital means short-term assets that will be depleted within one operating period. Expenditure incurred to acquire floating capital is revenue in nature (*New State Areas Ltd. v CIR (1946) 14 SATC 155* (AD) (at 163)). The goods or services acquired by the provider represents floating capital because the goods or services are short term and will be sold to customers (depleted) before the end of the operating period. Therefore, the expenditure incurred by the provider to acquire these goods or services is classified as revenue in nature.

In conclusion, the expense incurred by the CLP provider to acquire goods or services under a CLP does not create an enduring benefit for the provider and relates to the income-earning operations and not structure of the provider. Therefore, it is considered to be revenue in nature and not capital in nature and may be deductible

2.4.7 CONCLUSION

In conclusion, a CLP provider is able to obtain an income tax deduction for the expenditure incurred to settle the obligation to CLP customers when redeeming their CLP rewards. This expenditure meets all the components of the general deduction formula as it is an expenditure that is actually and unconditionally incurred by the provider while carrying on a trade in a certain year. Furthermore, the expenditure is revenue in nature and is incurred in order to enable the provider to sell goods or services to customers and generate a non-exempt income (sales revenue is not exempt under the Act). While the Act does not have provisions of allowances that specifically relates to CLPs and that may be claimed by a CLP provider, two recent cases exist that examined the connection of CLPs and an allowance provided under section 24C of the Act. These court cases are discussed in the following section.

2.5 SECTION 24C

The previous section concluded that the expenditure incurred by a provider under a CLP will likely meet all the elements of the general deduction formula and be deducted from the taxable income of the provider. This section examines possible income tax allowance implications envisaged in section 24C. In many instances the CLP provider earn revenue in one year of assessment knowing that they are obliged to make settlements to CLP customers in the following year of assessment. Hence, they are taxed on the income earned in one year but are only able to deduct the costs for the CLP expenditure (under the general deduction formula) in the following year. In this instance, CLP providers suffer significant cash flow consequences. Two CLP providers identified this issue and attempted to take advantage of a section of the Act specifically designed to address such disparities, even though it was designed for those in the construction industry.

In this context, section 24C of the Act provides an allowance against taxable income to a taxpayer (a provider in the case of a CLP transaction) who receives revenue in advance. Provided that the revenue will be used to pay for "future expenditure", which is costs incurred to settle CLP obligations to CLP customers, for example, it will be allowed as a deduction under section 11(a) of the Act. Therefore, while section 11(a) focusses on a deduction for the costs incurred by the provider in a CLP transaction, section 24C focusses on an allowance for any advance revenue received by the provider in a CLP transaction, and therefore, combats the cash flow complications experienced by CLP providers. The cases of *Clicks* and *Big G* are of particular importance in this regard as both appeared in the Constitutional Court and set a precedence as to how, if at all, section 24C can apply to CLPs. The following are analyses of the issues, facts and judgement of each of these cases.

Clicks Retailers (Pty) Ltd. (Clicks) operates a CLP called Clicks ClubCard (ClubCard) where members of ClubCard earn CLP points for purchase transactions at Clicks or one of Clicks' loyalty partners. The operation of the CLP is similar to the generic operation outlined in section 2.2, and Clicks claimed a section 24C allowance for the expenditure that will be incurred using the revenue that was attributed to the CLP rewards, which it considered to be the advance income for purposes of section 24C. SARS rejected this claim and raised additional tax assessments on the same basis as the *Big G* case.

In *Big G,* SARS issued additional assessments on Big G Restaurants (Pty) Ltd. (the taxpayer in this case) because the taxpayer was disallowed to claim a section 24C allowance. Earlier, in *ITC No 1905* (2018) 80 SATC 223, the Tax Court set aside the additional assessments issued by SARS for Big G on the basis that the revenue from the sales to customers is inextricably linked to the obligations created by the franchise agreement and therefore could be claimed as a section 24C allowance for future renovations expenditure. However, SARS disagreed with the ruling of the Tax Court and appealed the matter in *CSARS v Big G Restaurants (Pty) Ltd.* (2019) 81 SATC 185 (SCA). However, in the appeal case, the SCA ruled in favour of SARS, reasoning that the revenue earned by Big G from customers does not arise in connection to the franchise contract because the "income-earning contract" is not the same as the "obligation-imposing contract" (at 187). When the taxpayer appealed the matter in the *Big G* case, Judge Madlanga J upheld the ruling of the Supreme Court of Appeal (SCA) that the income received from customer sales and the obligation to effect renovations arise from two different contracts (at 406).

Similarly, in the *Clicks* case SARS reasoned that the income from CLP customers and the performance obligation created under the CLP related to two different contracts. The matter was brought before the Tax Court in *ITC No 1915* (2018) 80 SATC 214 (*ITC 1915*). In *ITC No 1915* (at 216) SARS argued that according to SARS IN 78 (2014:10), allowance for future expenditure on contracts provides that the advance revenue and the future expenditure need to arise from the same contract. SARS further used the principle established in the *Big G* case (at 29), which is that the "income-earning contract" and the "obligation-imposing contract" need to be the same contract in order for section 24C to apply.

Furthermore, in *ITC No 1915* (at 216) Clicks argued that the contract was a compound and inseparable contract that consists of the CLP contract and a contract of sale between Clicks and the customer. Therefore, the composite contract is the one contract that gives rise to both the obligation to incur future expenditure (as envisaged in section 24C) and the revenue from customers. On that basis, Clicks argued that a section 24C allowance can be claimed because all the requirements of section 24C were met. However, earlier in the Tax Court (*ITC No 1915*), the court ruled in favour of Clicks and held that the sale contract consists of the revenue received and the obligation to incur future expenditure. Therefore, only one

contract gives rise to the revenue and the obligation. Furthermore, the Tax Court stated (at 217 and 218) the following:

> "It is artificial to regard the future expenditure the taxpayer will incur when a customer redeems a voucher as arising under a 'different contract' to the first purchase and sale contract concluded with the same customer (and pursuant to which the points concerned were generated). In fact, in my view, it is not only artificial to do so but it is factually incorrect."

The SARS disagreed with the ruling of the Tax Court and appealed the matter in *CSARS v Clicks Retailers (Pty) Ltd. (2020)* 82 SATC 167 (SCA). In *CSARS v Clicks Retailers (Pty) Ltd. (2020)* 82 SATC 167 (SCA) (at 170 and 171), the SCA ruled in favour of the SARS on the basis of many of the principles established in the *Big G* case, namely that the "income-earning contract" must be the same as the "obligation-imposing contract" and that the "inextricably linked contract" does not equate to "the same contract". The SCA held that the income and the obligation arose from two different contracts (the sales contract and CLP contract respectively) and that the fact that the two contracts are inextricably linked does not mean that they are one contract or the same contract (at 170). Clicks appealed the decision of the SCA at the Constitutional Court, which ruled that Clicks failed to prove the crux of the matter, which is whether or not the contracts were the 'same' and further upheld the decision of the SCA (at 75).

In conclusion, the aforementioned two cases are kindred not only because they are two of the few section 24C tax cases to appear before the Constitutional Court of South Africa, but also because they are two of the first cases to address or be linked to the taxation of CLPs in the South African context. Interestingly, while the taxpayers in these cases failed in their attempts to claim a deduction under section 24C of the Act (for future expenditure to be incurred in relation to their CLPs), they are still able to deduct expenditure incurred in respect of the CLPs under the general deduction formula envisaged in section 11(a) of the Act (Brink, 2014; Pidduck & Odendaal, 2013a:1526).

2.6 VALUE-ADDED TAX DISCUSSION

In addition to income tax implications relating to CLPs, the SARS also imposes an indirect, consumption tax known as VAT. The SARS has made provisions for VAT to be levied on

parties in a CLP, namely the provider, customer, loyalty and redemption partners, in different circumstances. Prior to discussing and understanding what the VAT implications in CLPs are, it is necessary to understand what VAT is in the South African context. VAT is levied in South Africa under the Value-Added Tax Act 89 of 1991 (hereafter referred to as the VAT Act). VAT is an indirect tax that is levied on the consumption of goods or services by customers (South African Government, 2022). Essentially, VAT was instituted by the SARS to be able to levy a tax on the value that is added by a business at every phase of manufacturing or distributing the goods and services (South African Revenue Services, 2022b). The SARS obligates certain qualifying businesses to charge a VAT of 15% on the qualifying goods and services that they supply to their customers. Certain qualifying customers are allowed to claim the VAT that they paid on their purchase back from the SARS. Businesses qualify to levy VAT and customers qualify to claim a VAT deduction if they are satisfying the requirements to register as VAT vendors under the VAT Act. Furthermore, goods and services are subject to a VAT of 15% unless the VAT Act provides that no VAT be levied on the goods or services or that VAT be levied at a rate of 0% rather than 15% (South African Revenue Services, 2022b).

In CLP transactions, the provider operates a business that supplies goods or services to the customer. The supply of any qualifying goods or services by the provider to the customer will have a 15% VAT levied thereon by the provider if the provider qualifies to charge VAT. If the customers qualify, they will be able to claim a deduction of the VAT they paid on their purchase from the SARS. However, CLPs entail more than just a sale of goods or services by a provider to a customer. The multiple facets of a CLP outlined in section 2.3 have different complex VAT implications. Therefore, the SARS (2021:3) issued IN 118: 'Value-Added Tax consequences of points-based loyalty programmes' to detail and clarify the various VAT implications relating to the multiple features of CLPs. SARS INs are not statutes nor are they additions or enhancements to legislative provisions (South African Revenue Services, 2022a). The purpose of INs is to provide a recommendation to the tax scholarship on how to interpret and apply certain legislative provisions in order to remain tax compliant with the SARS (South African Revenue Services, 2022a). Furthermore, it was in held in *ITC No 1572* (1993) 56 SATC 175 that SARS INs, though they represent a practical and

reasonable interpretation of the laws, are not legally binding on South African courts or taxpayers.

According to IN 118 (SARS, 2021) the following VAT consequences are applicable to CLP transactions:

1. **Granting of a right to participate** in a CLP and the performance of a management or administration function is considered to be two taxable supplies of two services by the provider to the customer. Any fee paid for the supplies will be subject to VAT at 15% (South African Revenue Service Interpretation Note 118, 2021:9).
2. **Sale of goods or services to the CLP customer** by a CLP provider or partner is a supply, and if the supply is a taxable supply, VAT will be chargeable at 15% (or 0%). Furthermore, any points fee paid by a CLP partner to the provider will not serve as a reduction (discount) of the 'value' in the supply, is a way of attaching a monetary value to the CLP rewards (a medium of exchange), and is a transfer of money (South African Revenue Service Interpretation Note 118, 2021:10).
3. **Awarding CLP points** is akin to granting the customer a "right to future goods or services" and will be a taxable supply with no value if no additional consideration is paid by the customer to receive that right, and therefore, no VAT is chargeable and claimable on that supply (South African Revenue Service Interpretation Note 118, 2021:12). If additional consideration is paid by the customer to obtain the CLP points, then the supply is considered to be a supply of a "voucher, token or stamp" under section 10(18) of the VAT Act, and the VAT thereon will be chargeable and claimable at 15% or 0% on the date the points are reconsidered and not on the date that they were awarded (South African Revenue Service Interpretation Note 118, 2021:13).
4. **Gratuitous transfers** of CLP points between members of the same CLP does not have any VAT implications for the members, provider or the CLP partner. However, the sale of CLP points between members of the same CLP (who are both vendors) for a consideration has the same VAT implications (for the two transacting parties) as the awarding of CLP rewards by an provider to a customer

for an additional consideration (explained in the preceding point) (South African Revenue Service Interpretation Note 118, 2021:15).

5. An employer is a CLP provider, and **awarding CLP rewards to employees** is called a 'fringe benefit' because it is a non-cash remuneration granted to the employee and the employer provider is considered to make a supply and charge output tax at 15% on the value of the rewards less any consideration paid by the employee to acquire the rewards (the value of the benefit received by the employee). An employee that is a vendor can claim an input tax on the supply (South African Revenue Service Interpretation Note 118, 2021:16).
6. When a **customer redeems the CLP points or rewards** by purchasing goods or services from either the provider or the redemption partner (the redeemer), the provider or the redemption partner makes a supply to the customer at the open market value of the CLP points or rewards (the value attributable to the points or rewards by the provider) and/or the money received from the customer, including consideration paid to initially acquire the CLP points or rewards. The supplier vendor will charge an output tax of 15% or 0% if the supply is a taxable supply and a vendor customer will claim an input tax on the same supply (South African Revenue Service Interpretation Note 118, 2021:17).
7. When a **customer donates** the CLP points, there are no VAT consequences because the redeemer does not make any supply to the customer under the CLP (South African Revenue Service Interpretation Note 118, 2021:15).
8. When **a discount against a future supply is provided**, the redeemer must apportion the discount between all the supplies that the discount is being applied against based on the value of each supply. The redeemer will then charge output tax on the discounted value of each supply at 15% or 0% if the supplies are taxable supplies. A vendor customer will then be able to claim input tax on the supply (South African Revenue Service Interpretation Note 118, 2021:17).
9. If a **provider pays the redemption partner** a redemption fee, there are no VAT consequences on that transfer because it is merely a transfer of money as defined in section 1 of the VAT Act and falls out of the ambit of the VAT Act (South African Revenue Service Interpretation Note 118, 2021:18).

10. When there is an **exchange of the rewards** or points of another CLP (second CLP), the provider of the second CLP is considered to be the redemption partner of the rewards or points of the first CLP, and the VAT consequences that arise will identical to those in point 1 above (South African Revenue Service Interpretation Note 118, 2021:19).
11. Should **CLP points or rewards expire** before the customer obtains the benefit in them, there will be no VAT consequences that arise for any party because the provider did not make any supply to the customer under the CLP (South African Revenue Service Interpretation Note 118, 2021:20).

In conclusion of the VAT discussion, many elements of CLP transactions meet the definition of a 'taxable supply' and may have VAT implications as indicated in the IN 118 (SARS, 2021). However, it is possible to have a CLP that is so unique, it falls outside the scope of the VAT Act and/or IN 118. In such an instance, SARS advises that an "application be submitted for a VAT Ruling, under section 41B read with Chapter 7 of the Tax Administration Act 28 of 2011, to obtain certainty on the VAT implications of participating in such a CLP".

2.7 GROSS INCOME DISCUSSION

After discussing the tax implications from the perspective of the CLP provider, it is necessary to discuss the income tax implications in CLP transactions for the customers. The rewards received by customers in CLPs are not included in the gross income of the customer in practice. However, some published literature has suggested the taxation of CLP rewards in the hands of the customer (Odendaal & Pidduck, 2014; Pidduck & Odendaal, 2013b; Pidduck *et al.*, 2019; Swanepoel & Pidduck, 2020). Before we discuss the gross income implications of CLPs, we need to first understand what gross income is. The Act aims to tax any amount or benefits that meet the definition of gross income. Section 1 of the Act defines 'gross income' as follows:

"In relation to any year or period of assessment, means

1. In the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such a resident or

2. In the case of any person other than a resident of the Republic, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,

during such a year or period of assessment, excluding receipts or accruals of a capital nature."

Further included in the definition of gross income are amounts known as 'special inclusions', which do not satisfy all the elements of the gross income definition but are included into gross income. The Act does not make any provisions for customers to include the rewards they receive under CLPs into gross income as a 'special inclusion'. In order to determine whether CLP rewards should be included in the gross income of a taxpayer, an analysis of all the components of the definition is required. The analysis consists of a discussion of the four components of this definition in the following subsections.

2.7.1 TOTAL AMOUNT IN CASH OR OTHERWISE

'Total amount in cash' means the purchase price being received by the seller or the money being placed into the till of the seller *(ITC No 24510* (2019) CPT 1). However, in *Lategan v CIR* (1926) 2 SATC 16 (CPD) it was held that the term 'total amount' should be given a wider meaning and should include the value of any non-cash consideration earned in a transaction. Hefer JA expressed in *Lategan v CIR* that an unfairness will exist if transactions that are not denoted by money, are side-lined by tax legislation. Further, *CIR v Butcher Brothers (Pty)* Ltd. (1945) 13 SATC 21 (AD) and *C:SARS v Brummeria Renaissance (Pty) Ltd.* (2007) 69 SATC 205 (SCA*)* held that if the consideration is not in the form of cash (money) and the item cannot be converted to cash (money), then that item needs to have an "ascertainable monetary value" in order for the words "or otherwise" to apply. Therefore, the transaction must be settled in cash or must have a value that can be determined in order to satisfy the gross income element of 'total amount in cash or otherwise'.

CLPs such as the ABSA Rewards grant their members the benefit of receiving the cash that they spent in prior transactions back ('cashback'), and in this case the 'total amount' will be the cash obtained by the customer (Absa Bank Limited, 2022). Conversely, CLPs such as FNB's eBucks and Pick n Pay's Smart Shopper do not award a cashback benefit to their members (FirstRand Bank Limited, 2021; Pick n Pay Stores Limited, 2022). The total

amount for CLPs that do not provide a cashback benefit to their members will be the 'ascertainable monetary value' of either the CLP rewards or points themselves or the goods or services that the customer eventually redeems the rewards or points for.

The value of the redeemed item is the selling price of that item by the CLP provider. The point-to-Rand conversion ratio that CLP providers have implemented in their CLPs will be used to determine the monetary value of CLP rewards or points; for example 100 Pick n Pay SmartShopper points equals R1, and 10 FNB eBucks points equals R1 (FirstRand Bank Limited, 2021; Pick n Pay Stores Limited, 2022). Therefore, the principle established in *Lace Proprietary Mines Ltd. v CIR* (1938) 9 SATC 349 (AD) becomes imperative in resolving this conundrum regarding the value of CLP rewards or points. It was held in *Lace Proprietary Mines Ltd. v CIR* that the intention and the price of any transaction must be specified in order to avoid confusion. Therefore, the value of CLP rewards or points will be the price attached to the rewards or points earned as stipulated in the CLP contract between the provider and customer. Conversely, if the customer redeems the CLP points for goods or services, then the monetary value is the selling price of the goods or services as established by the provider.

It can be concluded with reasonable certainty that the 'total amount in cash or otherwise' component regarding CLP rewards will be satisfied. The reasons for that is if an amount of cash is earned in a CLP transaction, then the cash amount will satisfy the component and if the amount earned in a CLP transaction is not cash, the monetary value associated with the CLP rewards or points is ascertainable and will satisfy the component.

2.7.2 RECEIVED BY OR ACCRUED TO OR IN FAVOUR OF

This section addresses the timing and when the total amount should be included in the gross income of the customer. Section 1 of the Act states that the amount will be included in gross income when it is "received by or accrued to or in favour of" the taxpayer. *SIR v Silverglen Investments (Ply) Ltd.* (1969) 30 SATC 199 (A) established the principle that if a total amount is received by and accrues to the taxpayer at different points in time, the event (receipt or accrual) that occurs first will determine the time when the amount will be included into gross income. Further, in *SIR v Silverglen Investments (Ply) Ltd.*, Steyn CJ further ruled that a

taxing authority is not at liberty to tax any amount in the year of its accrual in instances where the receipt of the amount occurred and/or was disclosed in a previous year of assessment.

The Act does not provide a definition for the words 'received by'; however, the *Geldenhuys v CIR* (1947) 14 SATC 419I) case established that the term 'received by' means that the taxpayer should receive the amount for their behalf and own benefit. Furthermore, it was also held in *Geldenhuys v CIR* that in order for the taxpayer to 'receive' the amount for their own behalf and benefit, the taxpayer needs to have ownership of that amount because receipt without ownership leads to an illogical and unreasonable interpretation of this law. Therefore, in order for members of CLPs to receive the amount relating to CLPs for their own behalf and benefit, the members need to have ownership of that amount. However, due to the contractual condition/clause that deems the provider to be the rightful owner of the CLP card, a conundrum exists regarding whether the customer has indeed received the CLP rewards/points for their own behalf and own benefit and regarding the point in the CLP transaction when the CLP rewards might be classified as gross income. The ownership contractual clause creates two separate conversations regarding the time of including the CLP rewards or points into the gross income of the customer. These two conversations, namely including the rewards or points into gross income when the rewards are awarded to the customer or when the rewards or points are redeemed by the customer (Swanepoel & Pidduck, 2020:91), are discussed in the following subsections.

2.7.2.1 CUSTOMER IS NOT REQUIRED TO HAVE OWNERSHIP OF THE CLP CARD

Some CLPs require a physical presentation of the CLP card in order for the CLP member to be able to transact and earn benefits under the CLP; conversely, some CLPs do not have this requirement. In this discussion it will be established whether physical presentation of a CLP card is required from the customer to determine whether the amount is indeed 'received by, on behalf of and for the benefit of' the customer, and in addition, to determine whether the time of classifying the amount as 'gross income' will be at the point the rewards are awarded to the customer or at the point the rewards are redeemed by the customer.

CLPs such as SPAR Rewards and Shoprite's Xtra Savings do not require the physical presentation of the card when transacting and using or earning CLP rewards/points (Shoprite Holdings Limited, 2021:1; The Spar Group Limited, Not dated). However, the CLPs

do require a form of the customer's identification, such as a cell phone number or identification number, in order to prove an association between the customer and the rewards/points to allow the customer to use and benefit from the CLP rewards/points. In this instance the card and the points may have different owners at the same time because to be able to earn and own the rights in the form of CLP rewards/points, a customer does not have to physically present and own the CLP card. Therefore, the customer's separate ownership of the rewards/points coupled with the granting of the rewards/points to the customer at the time of transacting, holds the phrases **'**received by' and 'for their own behalf and benefit' satisfied at the point when the rewards are granted or awarded to the customer despite the fact that ownership of the card vests with the provider at the time (Swanepoel & Pidduck, 2020:91).

Moreover, in *Cactus Investments (Pty) Ltd. v CIR* (1999) 61 SATC 43 (A) it was held that a taxpayer earns gross income when they have performed all their duties under a contract. Therefore, once the CLP customers pay the providers to acquire goods or services and CLP points/rewards, the customer can be considered to have earned gross income in the form of CLP benefits because the customer has performed their duties (pay consideration for purchases) under the sale and/or CLP contract with the provider.

2.7.2.2 CUSTOMER IS REQUIRED TO HAVE OWNERSHIP OF THE CLP CARD.

CLPs such as Pick n Pay SmartShopper, Clicks ClubCard and Dis-Chem rewards require physical presentation of the CLP card when a customer transacts in order for the customer to be able to earn or use the CLP rewards/points in the same transaction (Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; Pick n Pay Stores Limited, 2022:1). This means that the ownership of the rewards/points cannot be separated from the ownership of the CLP card because to be able to earn and own the rights in the form of CLP rewards/points, the customer has to physically present and own the CLP card (Swanepoel & Pidduck, 2020:91). Furthermore, the customer cannot be seen as the owner of the rewards/points because the CLP provider remains the rightful owner of the CLP card. Therefore, ownership of the points and the card may vest with the provider of the CLP because the card and the points may have different owners. The customer will therefore not meet the 'received by' component of the definition when the CLP rewards or points are

awarded to the customer because the points are not ‘on behalf and for the benefit’ of the customer. However, when the customer redeems the CLP rewards/points, the customer obtains full ownership of the goods or services acquired by the customer after redeeming the CLP rewards/points. Therefore, the customer is considered to have ‘received’ the amount relating to the CLP rewards for their ‘own behalf and benefit’ at the point of redemption of the CLP rewards and not at the point when the rewards were awarded to the customer (Swanepoel & Pidduck, 2020:92). Alternatively, the rewards can be included in the gross income of the customer earlier than the redemption date provided the rewards ‘accrue to’ the customer before redemption date.

The term ‘accrued to’ is not defined in section 1 of the Act. However, ‘accrued to’ means that the taxpayer is entitled to the amount as held in *Lategan v CIR*. Furthermore, *CIR v People’s Stores (Walvis Bay) (Pty) Ltd.* (1990) 52 SATC 9 (A) established that an amount need not be ‘due and payable’ to the taxpayer in order to have ‘accrued’ to the taxpayer. If a right to an amount has vested to the taxpayer then the taxpayer is entitled to the amount and the amount has ‘accrued’ to the taxpayer. CLP rewards or points granted to a customer give the customer a right to utilise and derive benefit from those rewards or points at a future stage. The right of use that vests in the customer regarding the CLP rewards or points could indicate the entitlement that the customer has regarding the rewards or points. Furthermore, the right of use could be an indication that the amount associated with CLPs has ‘accrued’ to the customer.

However, entitlement does not address the consequences of suspensive and resolutive conditions on amounts to be received by the taxpayer. Therefore, in *Mooi v SIR* (1972) (1) 34 SATC 1 (A), it was established that for something to accrue to someone, that person must be unconditionally entitled to it. In such a case, the contractual condition/clause that deems the provider to be the rightful owner of the CLP card, makes the customer’s entitlement to the rewards or points conditional and creates a conundrum as to whether or not the rewards have accrued to the customer. When physical presentation of the card is required and a membership card is issued to the customer and they become the bearer of the card, the customer has the right to use the card despite the ownership of the card and rewards/points remaining with the provider (Swanepoel & Pidduck, 2020:92). In the *Clicks* case, Wallis JA ruled that the awarding of rewards/points onto loyalty cards and not the mere

issuance of a loyalty card creates performance obligations for the provider and a corresponding right and entitlement for the customer. Therefore, when those reward benefits are loaded onto the membership card held by the customer, the customer also has a right to the reward benefits loaded onto the card, which is an indication of entitlement to the reward benefits themselves, despite ownership still being held by the provider (Swanepoel & Pidduck, 2020:92). Therefore, the rewards/points do 'accrue to' the customer as soon as they are loaded onto the membership card or become available for use by the customer even if ownership of the rewards/points and card vests in the provider and not the customer. The customers may then include the total amount of the rewards or points in gross income before the redemption date.

Moreover, in rare instances, the CLP contract between the provider and the customer allows the customer to nominate a third-party charitable organisation to whom the rewards will be donated. That is the case with CLPs such as Pick n Pay SmartShopper and My School, My Village, My Planet rewards (Pick n Pay Stores Limited, 2022; Virtual Market Place (Pty) Ltd, 2021). However, as established in *CIR v Witwatersrand Association of Racing Clubs* (1960) 23 SATC 380 (A), a mere moral obligation to donate does not "destroy the beneficial character of the receipt". Therefore, the customer in a CLP is the true beneficial owner of the rewards/points according to the CLP contract because they are the recipient of the rewards before donation thereof.

The fourth and final component is 'excluding receipts or accruals of a capital nature', which is an area of great contention among tax scholars, is discussed in the following subsection.

2.7.3 RECEIPTS OR ACCRUALS OF A CAPITAL NATURE

According to *WJ Fourie Beleggings v CSARS* (2009) 71 SATC 125 (SCA), determining whether a receipt or an accrual is capital or revenue in nature is a common problem in income tax litigation. There is no definitive test that can be used to make that determination. It all depends on the intention of the taxpayer. However, according to section 102 of the Tax Administration Act 28 of 2011, the onus to prove that the receipts or accruals are revenue in nature rests on the taxpayer. In *CIR v Visser* (1937) 8 SATC 271 (TPD), it was held that the taxpayer should present their own evidence to prove what their intention was in order to discharge the onus. However, *CIR v Nussbaum* (1996) 58 SATC 283 (A) held that the

testimony of the taxpayer is subjective and the facts and circumstances of the case should instead be analysed to establish the true intention of the taxpayer.

In determining whether intention is capital or revenue in nature, the objective factors and whether the taxpayer is in a profit-making scheme must be considered, as held in *CIR v Pick 'n Pay Employee Share Purchase Trust* (1992) 54 SATC 271 (A). Some customers aim to optimise the benefits obtained from the CLP by actively participating in as many programmes as possible and by exploiting and exhausting all possible rewards opportunities available in all the programmes they participate in. The active and resolute participation can be an indication of a profit-making scheme and of the revenue nature of the CLPs. In contrast, some customers merely use the CLPs to obtain occasional serendipitous benefits when purchasing goods or services from the provider. Such inactive customers cannot be regarded as profit-making schemers and are therefore not bearing CLP rewards with a revenue intention.

However, it might be unclear at times what the true intention of the customer is. This is due to the ability of customers to change their intention in addition to the impracticability of constantly evaluating the intention of each customer. In *COT v Levy* (1952) 18 SATC 127 (A), it was held that if a customer has a mixed intention, the most dominant intention will be used to determine whether the amount is revenue or capital in nature. Furthermore, in CIR *v Nussbaum*, it was held that if the primary intention of the taxpayer is capital in nature, but the taxpayer develops a secondary intention that is revenue in nature, the revenue motive will prevail above the capital motive. Therefore, if CLP customers have different intentions with the CLPs at different points, they have a mixed intention and the most dominant intention will have to be established from the facts and circumstances. Furthermore, if the CLP customer initially holds the CLP rewards/points with a capital intention but subsequently changes the intention to a revenue intention, the true intention of the customer will be revenue in nature and the CLP rewards will be classified as gross income.

There is no absolute decision as to whether the CLPs are revenue or capital in nature in the hands of the customer because it is impractical to determine the individual intention of all CLP members in South Africa. Therefore, for the purpose of this study, the researcher argues for the application of the recommendations made by (Swanepoel & Pidduck,

2020:96) to include the rewards received in gross income as a special inclusion in order to override the possible capital in nature component of the definition of gross income.

2.7.4 CONCLUSION

The points received under CLPs have a cash or a determinable monetary value that is received by the customer and for the customer's own behalf and benefit when they redeem the rewards or points in exchange for the provider's goods or services. Furthermore, the rewards or points may 'accrue to' the customer at the time the rewards or points are earned by the customer. CLP rewards that are donated to a third party still accrue and are received in favour of the customer. Therefore, the rewards or points may be taxable in the hands of the customer. However, the findings regarding whether the rewards or points are capital or revenue in nature remain inconclusive. Therefore, a special inclusion provision regarding CLP rewards is the most viable manner in which CLP rewards and points may be included into the gross income of the customer.

2.8 FRINGE/EMPLOYEE BENEFITS DISCUSSION

CLP rewards invoke income tax implications on employees in the form of fringe benefits. However, in order to discuss the tax implications on CLPs relating to fringe benefits, fringe benefits must first be defined. Fringe benefits are defined in the Seventh Schedule of the Act as any non-cash remuneration paid by an employer to an employee for services rendered in the employment relationship. In essence, they are non-cash employment benefits. The Seventh Schedule requires the value of the fringe benefit, determined using the rules provided in the schedule, less any consideration paid by the employee to the employer to acquire the benefit, to be included in the gross income of the employee under special inclusion paragraph (i) of the gross income definition.

After discussing the possible gross income implications of CLP rewards for the customer, it was decided to heed the recommendation by Swanepoel and Pidduck (2020:96) to include the rewards in the gross income of the customer as a 'special inclusion'. To further support this notion, CLP points or rewards granted under an employment incentive scheme to employees by CLP providers who are employers meet the definition of a 'fringe benefit' contained in the Seventh Schedule of the Act as they are a non-cash remuneration received

by employees from employers. Therefore, the value of these fringe benefits needs to be included in the gross income of the employee using the special inclusion paragraph (i) of the gross income definition. Furthermore, South African Revenue Service Interpretation Note 118 (2021:16) states that “the awarding of the loyalty points by the employer to the employees, however, constitutes a fringe benefit under the Seventh Schedule to the Income Tax Act 58 of 1962”.

This means that these CLP rewards will be included in the gross income of the employee using special inclusion paragraph (i). Therefore, the same rationale used to include these CLP rewards in gross income as a special inclusion can be used to enforce the recommendation made by Swanepoel and Pidduck (2020:96). Therefore, a suggestion is made by the researcher that the Seventh Schedule of the Act be modified by the SARS in order to specifically provide for fringe benefits tax implications of CLP rewards. The only provision that the SARS has made regarding CLP rewards as fringe benefits is in relation to IN 118 (SARS, 2021) and the VAT deemed supply nature of the fringe benefits under s18(3) of the VAT Act.

2.9 CONCLUSION

Chapter 2 provided a discussion of CLPs in the South African context. The discussion included an analysis of authoritative literature, such as peer reviewed journal articles, provisions from South African laws, regulations, statutes and government reports and principles established in seminal case laws. This chapter established that CLPs rewards are used by providers as a marketing tool to improve sales and retain loyal customers and that CLP points are a form of e-currency that can be exchanged for goods or services in a sale transaction. It was further established that the benefits received by the provider and customer in a CLP may be taxable as gross income and fringe benefits under the Act and as taxable supplies under the VAT Act. Furthermore, CLP providers may obtain a section 11(a) deduction for the expenditure incurred to acquire the goods or services they sell, provided they satisfy the ‘general deduction formula’. However, providers are disallowed from claiming an allowance under section 24C of the Act for future expenditure to be incurred under the CLP. This is due to the principles established in the *Clicks* and *Big G* cases,

namely the income-earning contract and the obligation-imposing contract have to be the same contract.

CHAPTER 3: TAX TREATMENT OF CUSTOMER LOYALTY PROGRAMMES INTERNATIONALLY

3.1 INTRODUCTION

In Chapter 2, we analysed all the existing and recommended tax implications of CLPs in a South African context using authoritative literature. This chapter researches, analyses and provides the findings relating to CLPs in Australia, Canada, New Zealand, the UK, and the USA. The basis of selection for the countries is outlined in section 1.6.2. The analysis are performed separately for each jurisdiction and consists of the following steps:

1. Obtain historic, if available, and current statutes, case laws, legal documents and/or legal rulings from the authoritative sources outlined in section 1.6.2.
2. Study the above provisions by establishing which party in the transaction it applies to, what manner of tax they apply to, the scope of the manner of tax they apply to, when they were/are applicable, and how they relate to CLPs.
3. Explain the progression from the historic laws to the current applicable laws.

The analysis is performed to achieve the objective of this study, which was to expose the mechanisms used to tax CLPs internationally using authoritative literature. The findings of this study contribute to the body of knowledge in South Africa for the purpose of understanding how CLPs are treated from a tax perspective for comparative purposes and to help determine the progress that South Africa has made in establishing a national tax regime for CLPs.

3.2 AUSTRALIA

Before we assess the tax treatment of CLPs in Australia, we first have to determine whether Australia has CLPs, and if so, understand what CLPs are in the Australian context. Australia has CLPs in industries ranging from retail, hospitality, financial institution and the airline industry (Steinhoff & Palmatier, 2016:90). In Australia, CLPs are called customer loyalty schemes and are defined as marketing and advertising instruments used to encourage repetitive commercial connections and engagements with consumers (Sharp & Sharp, 1997:474; Steinhoff & Palmatier, 2016:88). Customers earn benefits in the form of discounts

or points, which can be redeemed for goods and/or services from the provider. The tax implications for each form of tax that is instituted by the Australian government on CLPs may relate to either the customer or the provider, and each is discussed in greater detail in the following subsection.

3.2.1 INCOME TAX

Income tax is levied on Australian citizens and non-citizens under the Australian Income Tax Assessment Act 38 of 1997 (hereafter referred to as the Australian ITAA). Section 3–5 of the Australian ITAA obligates each company and individual in Australia to pay income tax for each income year. According to section 4 of the Australian ITAA, income tax can be quantified with reference to the taxable income of the taxpayer, which is comprised of assessed income less deductions. The assessed income of a taxpayer is derived from the ordinary and statutory income that is earned or received by the taxpayer in the tax year. Ordinary income is defined as income earned from ordinary activities of a taxpayer, such as rendering services and business trading activities (Australian Tax Office, 2017:1). Conversely, statutory income is income that is not ordinary income as defined but is mandatorily included in the assessed income of the taxpayer by existing laws (Australian Tax Office, 2017:1). Therefore, a CLP provider will need to include the sales revenue earned from a CLP transaction in their assessed income if the inclusion is obligated by law or is warranted by the source of the income being either trading activities, services rendered or properties. This lawful requirement by the Australian government is similar to how the ‘gross income’ definition of the Act applies to CLP providers in South Africa. However, the difference between the two countries is that the Act in the South Africa excludes amounts of a capital nature from being included into gross income, whereas the Australian ITAA includes amounts that are ordinary or statutory income from all sources regardless of nature.

Furthermore, the Australian government recognised the taxable benefit in CLP rewards received by customers and made provisions to tax the value of these rewards as income under section 4–15 of the Australian ITAA. This is a stark contrast to South Africa where no provisions, other than recommendations by Swanepoel and Pidduck (2020), have been made to include CLP rewards earned by customers in gross income under the Act. However, in Australia and according to Australian Tax Ruling 6 of 1999 (Tax Ruling 6; ATO, 1999b),

CLP rewards earned by a customer will only be included in assessed income if they are ordinary or statutory income and provided all the following elements are present in the CLP transaction:

- The customer operates a business or enterprise and received the rewards in connection with their income-earning business;
- The customer and the provider have an existing business relationship; and
- The rewards earned by the customer can be directly converted into money or exchanged for something with a monetary value and provided that the taxpayer will be obligated to include the monetary value of any non-cash benefits received or earned by the business in their assessable income under section21A of the Australian ITAA (Australian Tax Office, 1999b:1).

Therefore, unlike suggestions by Swanepoel and Pidduck (2020), which aims to tax all customers who receive CLP rewards regardless of the circumstances surrounding the customer's acquisition of the rewards, the Australian government aims to tax the CLP rewards received by customers who use or intend to use these rewards by converting them into money or exchanging them for an item of monetary value in their income-earning enterprises (i.e. businesses or companies; (Australian Tax Office, 1999b:1). Therefore, the ATO will not impose an income tax implication for consumers who personally benefit from CLP rewards and do not utilise them for a business.

Notwithstanding the above, the Australian government has made separate taxing provisions for CLP rewards earned in the airline industries. According to Tax Ruling 6 (ATO, 1999b), CLP rewards earned by customers from providers in the airline industry will be included in the assessed income of the customer if the rewards is ordinary or statutory income and provided that the customer:

- Rendered a service in which the flight reward was the sole or an additional agreed-upon remuneration; and
- Earned the reward due to incurring a business-related expense or in the course or furtherance of the customer's business activity.

Therefore, flight rewards will only be included in the assessed income of customers who earn them as a result of rendering a service as part of their trade. This will apply mostly to

employees, personal service providers or independent contractors who render a service to an employer and use the employer's business card to pay for any expenditures incurred in the course of rendering the service and operating the business of the employer (Australian Tax Office, 1999b:1). If the employer and employee contractually agree to the flight rewards being used as a form of remuneration for the services rendered, the value of the flight rewards will be included in the assessed income of the employee. Therefore, only CLP rewards earned by consumers from incurring personal expenditure will not be subject to income tax in Australia, according to Tax Determination 34 of 1999 (Australian Tax Office, 1999a:1). Conversely, the recommendations made by Swanepoel and Pidduck (2020) in South Africa relate to all CLPs in all industries and do not target a specific consumer group based on the manner in which the CLP rewards are earned or used.

3.2.2 FRINGE/EMPLOYEE BENEFITS

According to section 15–2 of the Australian ITAA, the assessable income of a person in employment shall include the value of non-cash remuneration or benefits awarded by the employer to the employee under an employer-employee contract. These are commonly referred to as fringe benefits and impose a fringe benefit tax obligation on the employer (Australian Tax Office Fringe Benefits Tax Guide for Employers, 2021:1). Furthermore, in the cases of *Smith v FCT* (1987) 87 ATC 4883 (HCA) and *J & G Knowles & Associates Pty Ltd.* v *COT* (2000) 44 ATR 22 (FCA), it was established that the benefit needs to have a notable connection to the employment relationship. The values of such benefits are determined based on rules provided under section 63 of the Australian Fringe Benefits Tax Assessment Act of 1986 (hereafter referred to as the Australian FBTAA).

The provision of goods or services (including food and travel services) is regarded as entertainment under the Australian FBTAA (Australian Tax Office Fringe Benefits Tax (2020). Therefore, the CLP rewards earned by employees when incurring business expenditure on behalf of the employee that will be redeemed for goods or services by the employees are considered entertainment, and the taxable fringe benefit value thereon will be the expenditure incurred by the employer to provide the entertainment to the employee (Australian Tax Office Fringe Benefits Tax, 2020). Therefore, the value of the CLP rewards is the cost incurred by the employer to acquire goods or services in the CLP transaction

where the rewards were earned. In the instance where the employer is a CLP provider, the value of the rewards is any cost incurred by the employer to award these rewards to the employee. (Australian Tax Office Fringe Benefits Tax, 2020:1). The provider will self-assess, determine the value and the tax applicable to all fringe benefits provided to employees in a tax year and be liable for all the tax on the fringe benefits provided by the employer (Australian Tax Office Fringe Benefits Tax Guide for Employers, 2021:1). This is different to South Africa where the fringe benefit granted to an employee is included in the employee's gross income under the Act and the employee becomes liable for the tax.

The Australian government has made provisions to include the value of CLP rewards received by customers in the assessed income of both the customer and the provider, whereas in South Africa, the recommendation is to tax the person deriving the benefit from the rewards (being the customer). However, in Australia, Tax Ruling 6 (ATO, 1999b) makes a further distinction between the tax implications from flight rewards and all other CLP rewards. According to Tax Ruling 6, flight rewards received by an employee in the course of furtherance of an employer's business will not invoke fringe benefit tax for the employer unless:

- The flight reward is granted to the employee in connection to an employment relationship and the employer and employee have an existing family relationship;
- The employer and the employee have a family relationship and the flight reward is received in connection with the employment relationship; or
- The flight reward was earned by an employee, or the employee's associate, under an arrangement for the purposes of the Australian FBTAA when incurring business expenditure for the employer's business (Australian Tax Office, 1999b:1).

If the requirements of Tax Ruling 6 (ATO, 1999b) are met, the employer does not have to pay a fringe benefits tax in relation to the flight rewards; however, the employee may still be required to include the value of the rewards in their assessed income if all the three requirements of Tax Ruling 6 for general non-flight rewards set out in section 3.2.1 of this study are satisfied. Where normally the employer and employee are both simultaneously taxed on the CLP rewards, in this case only the employee might be taxed. There are also further instances where CLP rewards will either be included in the assessable income of the customer or taxed as a fringe benefit in the hands on the provider (not both simultaneously).

This was established in *Payne v. FCT* (1996) 96 ATC 4407 (FCA), Tax Ruling 6 and Tax Determination 34 of 1999 (Australian Tax Office, 1999a:1) and applies to CLP rewards received by any customer or employee where:

- The sole commercial purpose of the contract is to award the rewards to the customer or employee;
- The employer and employee contractually agreed that the rewards would be in lieu of any other remuneration that the employee would have otherwise been entitled to; or
- The rewards are in the form of CLP points and the total accumulated points in the year exceed 250 000 (Australian Tax Office, 1999b).

Tax Ruling 6 (ATO, 1999b:1) requires that any such matter be referred to a senior tax official at the office who will make the final decision as to whether the reward is either assessable income for the customer or employee or a fringe benefit for the employer.

3.2.3 DEDUCTIONS FROM TAXABLE INCOME

Section 8 of the Australian ITAA provides for a deduction against 'assessable income' of any loss or expenditure incurred to the following extent:

> "(a) it is incurred in gaining or producing your assessable income; or
> (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
> However, you cannot deduct a loss or outgoing under this section to the extent that:
> (a) it is a loss or outgoing of capital, or of a capital nature; or
> (b) it is a loss or outgoing of a private or domestic nature."

Furthermore, section 8–5 of the Australian ITAA provides for a deduction on any loss or outgoing specifically listed in the section, which includes any loss or outgoing incurred in providing fringe benefits to employees. Therefore, any expenditure incurred by a CLP provider to acquire the goods or services sold in a CLP sale transaction may be deducted by the provider in calculating their taxable income. Additionally, any expenditure that is incurred by an employer when remunerating employees using fringe benefits, such as CLP

rewards, may also be deductible under this section. This section of the Australian ITAA is similar to the general deduction formula provided in the Act where taxpayers are able to deduct costs incurred to acquire the goods or services sold to customers (such as CLP transactions).

3.2.4 GOODS AND SERVICES TAX

GST is a tax levied under the Australian New Tax System Act no. 55 of 1999 at 10% on the supply and/or consumption of goods and services in Australia. The tax is levied by the supplier of the goods or services (the CLP provider). The ATO released Media Statement 2000/14 on 1 March 2000 that clarified that while membership fees to CLPs will attract GST, the accrual and conversion or redemption of points by customers into goods or services will not be subject to GST. Subsequent to Media Release 2000/14, the ATO provided Draft GST Ruling D3 of 2011, which was eventually finalised into GST Ruling 1 of 2012 in April 2012, that states the following:

> "When a member pays consideration for goods or services and gets points allocated to them in consequence, the member's payment is consideration for the supply of the goods or services they acquire. Accordingly, there should not be an apportionment of the amount paid by the member between the goods or services and the points." (Australian Tax Office, 2012:1)

3.2.5 CONCLUSION

The ATO imposes similar taxes to the SARS with regards to CLP rewards. In both jurisdictions, income tax is imposed on CLP providers for the revenue earned on CLP sales transactions. However, in Australia, income tax is imposed on customers that mostly receive the CLP rewards in relation to a business activity that they are carrying on, whereas South Africa does not levy income tax on CLP rewards in the customer's hands. Furthermore, the ATO provides for fringe benefit tax on employers who award rewards to employees as remuneration or a benefit of employment, and income tax deductions to the CLP provider for the costs incurred to acquire the goods or services that are sold by the provider to earn revenue and GST on the supply of goods or services to be consumed by the customer in a CLP transaction. The provisions of the two taxing authorities are very similar; however, there

are noteworthy differences, such as the ATO imposes income tax on both the employer and employee for the same CLP reward, whereas the SARS does not currently collect income tax in relation to the CLP rewards. However, the SARS outlines the various VAT implications for the different stages in a CLP transaction while the ATO only taxes the supply of goods or services at the initial CLP sales transaction. This analysis of how CLPs are taxed in Australia is summarised in Table 3.1.

Table 3.1: Summary of the Australian CLP tax analysis

	CLP Provider	CLP Customer
Direct income tax (deduction/Income)	The sales revenue earned by the provider in CLP sales transactions will be included in the provider's assessed income and may be taxed. Also allowed to deduct the cost of the goods and services from income.	Only CLP rewards earned in the course of the customer's business activity and that meet certain requirements will be included in assessed income of the customer.
Indirect /consumption tax	An employer must levy GST on any goods or services supplied as fringe benefits to employees. Furthermore, a CLP provider must levy GST on the supply of goods or services in a CLP sales transaction. However, the supplier of the CLP rewards is not required to levy any GST on the CLP rewards themselves.	Pays GST included in the purchase price of goods or services sold by the provider
Employees tax	The value of CLP rewards fringe benefits granted by an employer to employee will be included in the assessed income of the employer and taxed	

Source: Author's own design

3.3 CANADA

Before assessing the tax treatment of CLPs in Canada, it is important to first understand what CLPs are in the Canadian context. In Canada, CLPs are benefit programmes that grant points to customers in exchange for their personal information (Competition Bureau Canada, 2019:1). The provider establishes the CLP with the purpose of gaining new customers, retaining existing customers and encouraging customers to purchase more (Competition Bureau Canada, 2019:1). The benefits derived by the customer for being a 'loyal shopper' is the ability to redeem the points granted for gift cards, discounts, travel benefits and goods or services (Competition Bureau Canada, 2019:1). Now that CLPs in the Canadian context

have been defined, an analysis of the tax consequences created by CLPs follows. The taxes that influence CLPs that are instituted by the CRA are income tax, employees' benefits tax, medical tax credit, donations tax credit and GST. These tax implications are discussed in the following subsections.

3.3.1 INCOME TAX

Canadian income tax is governed by the Income Tax Act of 1985 of Canada, which taxes all the income earned or received by a Canadian or non-Canadian taxpayer from properties or businesses owned by the taxpayer or as remuneration for employment or holding of office. This means that sales revenue earned by CLP providers when selling goods or services in their businesses will be included in the income of the provider. However, CLP rewards earned by individuals for their personal use that are unrelated to any act of employment is not taxable income as defined in part 1 section 2(2) in the Income Tax Act 1985 of Canada (Canada Revenue Agency, 2022:1), and therefore, the rewards will be seen as a normal discount or coupon that has no income tax implications for the provider nor the customer (Canada Revenue Agency, 2022:1). This is similar to South Africa where the CLP rewards are not included in the income of the provider nor the customer in any capacity.

3.3.2 EMPLOYEE BENEFITS TAX

In addition to income tax, the CRA provides that any CLP rewards earned by an individual who is an employee in a transaction that involved an act of their employment will be regarded as a taxable employee benefit (Canada Revenue Agency, 2022:1). In this regard, it is noted that the employee could have used their own personal credit card to pay for business expenses and received personal CLP rewards in that same transaction (later reimbursed by the employer) or could have used the employer's business credit card to pay for business expenses to complete the transaction. Regardless of the method of payment, the CRA required the employee to determine the fair market value of the goods or service that the rewards earned would be redeemed for by the employee and include the fair market value of the CLP rewards in their taxable employment benefit (Canada Revenue Agency, 2022).

Notwithstanding the above, multiple complications arise, such as accurately distinguishing between rewards earned by the employees on their personal rewards card from CLP sales

transactions where business expenditure or personal expenditure was incurred and paid for, and accurately determining which CLP rewards were actually redeemed by the employee and have an ascertainable, taxable monetary value based on what the reward was redeemed for. Consequently, the CRA amended the provision and subsequently obligated the fair market value of all CLP rewards earned by an employee in their capacity as an employee be included in the income of that employee provided that

- The rewards are transformed into cash;
- A scheme exists between the employer and employee in which the rewards are intended to be used as an honorarium to the employee; or
- A scheme exists that has elements of tax avoidance (Canada Revenue Agency, 2022:1).

The CRA places the onus to declare and include the rewards in the income of the employee on different parties in different instances. Where the transaction was completed using the personal credit card of the employee, and as a result, the employer has no control over the CLP rewards earned, the onus rests on the employee to self-assess and determine the taxable benefit of the rewards based on what the employee redeemed the rewards for and include it in income (Canada Revenue Agency, 2022:1). Conversely, where the transaction was completed using the business credit card of the employer, the employer would receive a CLP rewards statement and would have knowledge and control of the CLP rewards and what they were redeemed for by the employee (Canada Revenue Agency, 2022:1). Therefore, the obligation will be placed on the employer to determine the taxable benefit of the rewards based on the value of the goods or services that the rewards were redeemed for, according to the statement, and report them on the income tax slip of the employee (Canada Revenue Agency, 2022:1). Therefore, the Canadian provisions are similar to the South African provisions that tax the employees for the fringe benefit received by them. Furthermore, the provisions of South Africa, Canada and Australia correspond with regards to determining the taxable value of the fringe benefit by using the value goods or services that the rewards are redeemed or exchanged for.

Additionally, the taxable benefits on the rewards are also considered to be pensionable by the CRA (Canada Revenue Agency, 2021a:1). The employer is required to deduct a portion of the benefit and make a contribution to the employees' Canadian Pension Plan (Canada

Revenue Agency, 2021a:1). Subsequently, the value of the pension contribution will be deducted from the income of the employee. Furthermore, the CRA provides that if the CLP rewards were paid for in cash, they are considered to be insurable and will receive an Employment Insurance premium deduction from the income of the employer (Canada Revenue Agency, 2021a:1). Employment Insurance are funds set aside to financially assist the employee in the event that they find themselves without employment. These are unique tax implications not specifically provided for in South Africa or Australia as South Africa does have a retirement contribution deduction and contributions to the Unemployment Insurance Fund, which serves a similar purpose as the Canadian Insurance. However, the deduction and contribution provisions are not invoked by CLP rewards.

In addition to non- cash employment benefits, the CRA requires employees that obtain travel allowances from their employers for business travel purposes to include the allowance received in their income unless the employee is a member of parliament or an employee of the CRA, who utilises CLP rewards earned to pay for the travel expenses (Canada Revenue Agency, 2021b:1). In South Africa, section 8(1) of the Act requires the net travel allowances that were received by employees to be included in the income of the employee. Net travel allowances are the total travel allowances granted by the employer to the employee less the portion of the allowance used to pay for business expenditure, regardless of how the employee paid for the expenditure. Therefore, the employee may pay for the business travel expenses incurred using CLP rewards and will still be able to deduct the expense from the net travel allowance included in their income, which is different from the CRA's treatment of travel allowances where Canadian employees have to include travel allowances received in their income in full with no regard to any business expenses paid for or how they were paid for unless the employee works for the CRA or parliament and paid for business travel expenses using CLP rewards, in which case the allowance received by such employee may be excluded from income.

3.3.3 INCOME TAX MEDICAL CREDIT

According to section 118.2 of the Canadian Income Tax Act, a Canadian taxpayer is allowed to claim a non-refundable medical expenses tax credit. The tax credit may be claimed for medical expenses that have been incurred and paid for by the taxpayer, the taxpayer's

spouse/partner or the taxpayer's minor children. Furthermore, the taxpayer will only be allowed to claim the tax credit provided that the medical expenses are incurred and paid for in the relevant tax year and provided the medical expenses were not paid for nor reimbursed by any medical aid/insurer (Canada Revenue Agency Claiming Deductions Credits and Expenses, 2022:1). In addition to being liable for personal income tax on CLP rewards as an employee or non-employee, an individual taxpayer is permitted to claim a medical expenses tax credit from income on all travel costs if they were obligated to travel more than 40 kilometres to obtain medical attention (Canada Revenue Agency Claiming Deductions Credits and Expenses, 2022:1). Therefore, a taxpayer that incurs expenditure to travel more than 40 kilometres for medical care and pays for the expense using CLP rewards may still be allowed to claim a medical expenses tax credit from income (Canada Revenue Agency Claiming Deductions Credits and Expenses, 2022:1). This was further reinforced in the case of *Johnson v. The Queen* 2010 TCC 321 where it was established that if CLP rewards are used as a form of payment for the medical travel expenses, the cost of the expense paid for may still be allowed as a medical expenses tax credit. This provision is similar to the section 6B credit available in the Act of South Africa where an individual taxpayer can obtain a credit from income for any medical expenses incurred and paid for by the taxpayer and not a medical insurer regardless of travel distance. However, the section 6B credit does not provide for different implications for instances where the taxpayer paid for the medical expense using CLP rewards.

3.3.4 DEDUCTIONS FROM TAXABLE INCOME

Section 18 of Canada's Income Tax Act of 1985 allows a taxpayer to deduct any 'outlay' or expenditure incurred by the taxpayer with the intention of earning or producing business-related income. Therefore, any expenditure incurred by a CLP provider to acquire the goods or services that are sold in a CLP sale transaction can be deducted by the provider in calculating their taxable income. Additionally, any expenditure that is incurred by an employer when remunerating employees using fringe benefits such as CLP rewards may also be deductible under this section because all the operational expenditure incurred by the provider is incurred in order to make sales to customers and earn income This section is comparable to the general deduction formula in the Act of South Africa where CLP

providers are able to deduct costs incurred to acquire the goods or services sold to customers in CLP transactions.

3.3.5 DONATIONS TAX

The CRA grants a non-refundable tax credit to a taxpayer for the value of any charitable donations made by the taxpayer, subject to certain limits (Canada Revenue Agency Claiming Charitable Tax Credits, 2020:1). A taxpayer may claim this credit only if the donation is made to a registered charity that is listed in the CRA's list of qualifying recipient charities (Canada Revenue Agency Claiming Charitable Tax Credits, 2020:1). Therefore, the CRA will grant a donations tax credit for any donations, subject to certain limits, of CLP rewards or any donations funded by CLP rewards provided the rewards/goods are transferred to the charity and can be valued with reasonable certainty. The donations tax credit will be equal to the value of the rewards in instances where the loyalty points are donated or equal to the value of the goods in instances where goods purchased using loyalty points are donated (Canada Revenue Agency Claiming Charitable Tax Credits, 2020:1). Various South African CLPs have an option to donate rewards to a charitable organisation. There are no specific provisions in the Act that allow customers to deduct donations made using CLP rewards from income; however, if the organisation is a Public Benefit Organisation and awards the customer who made the donation a section 18A certificate as envisaged in the Act, the customer may obtain an income tax deduction, similar to the Canadian donations credit, equal to the value of the donation determined using the rules provided in section 18A and limited to 10% of the taxpayer's taxable income for the year.

3.3.6 GOODS AND SERVICES TAX

In addition to levying income tax on CLP rewards, the CRA obligates suppliers of goods and services to levy a 5% Canadian GST under the Canadian Excise Tax Act of 2001. The consideration received by the CLP provider to supply goods or services to a customer relates in general to the goods or services, and therefore, GST will be levied on the supply thereof. However, in *Canadian Imperial Bank of Commerce v. The Queen* 2019 TCC 79 (FCA), the taxpayer argued that the CLP rewards earned in a transaction are gift certificates for the purpose of excise tax and not GST. The court held that the rewards were not gift certificates

for the purpose of excise tax but were a part of a marketing and promotional service rendered by the provider to the taxpayer, and therefore, making the CLP rewards taxable supplies on which the taxpayer was levied a GST (at 110). Therefore, the consideration received by the provider in a sales transaction with the customer needs to be apportioned between the goods or services supplied to the customer and the CLP rewards awarded to the customer. This is because the rewards are regarded as an additional supply made to the customer in the same transaction and GST may be levied on the rewards (at 110). The provisions are similar to South Africa VAT and Australian GST in terms of the consumption tax levied on the supply of goods or services; however, it vastly differs from the VAT treatment because the VAT Act does not levy VAT on the supply of the CLP rewards or on the CLP rewards themselves, and furthermore, the VAT Act accounts for VAT at different stages of a CLP transaction, such as redemption, expiry, and conversion, in South Africa.

3.3.7 CONCLUSION

The Canadian tax implications on CLPs are similar to the Australian and South African tax implications with regards to inclusion of sales revenue earned by the provider in income, instituting an employee benefits tax on CLP rewards granted to employees as employment benefits or remuneration, awarding the provider a tax deduction from income for the expenses incurred in producing the sales revenue, and levying a consumption tax on the supply of goods or services by the provider. However, the CRA grants new unique tax benefits to the customer in the form of a GST on the rewards awarded to the customer, a contribution to the pension plan of the customer employer if the employer received the CLP rewards in cash, a subsequent deduction from income equal to the contribution, a contribution to the unemployment insurance of the employer, a medical expenses credit for expenses paid for by the employer using CLP rewards, and a donations tax credit for donations made by the customer using CLP rewards. This analysis of how CLPs are taxed in Canada are summarised in Table 3.2.

Table 3.2: Summary of the Canadian CLP tax analysis

	Provider	Customer
Income tax (deduction/income/employees' tax)	Includes sales revenue earned in the sale of goods or services to the customer as part of the CLP transaction. Also allowed	CLP rewards granted to employees under an employment contract are subject to an employee benefits tax. All other CLP rewards earned in any other

	Provider	Customer
	to deduct the cost of the goods and services from income.	circumstance are not subject to income tax.
Indirect/consumption tax	Levies a GST on the supply of goods or services to the customer as well as on the supply of CLP rewards to the customer. The consideration received from the customer will be split between the two supplies.	Pays a GST on goods or services supplied by the provider and on CLP rewards obtained from the provider. The tax is included in the purchase price that is apportioned between the goods/services and the rewards.
Other taxes		Obtains an income tax deduction for contributions made to the taxpayer's employee pension fund and obtains a tax credit for donations made and medical expenses paid using CLP rewards.

Source: Author's own design

3.4 UNITED KINGDOM

In the UK, CLPs are loyalty schemes that grant customers rewards and incentives to motivate them to remain loyal users of the provider's brand (Statista (2018:1). The HMRC of the UK instituted the taxes discussed in the following subsection on CLPs in England.

3.4.1 INCOME TAX

Section 4 of the UK's Income Tax Act of 2007 (hereafter referred to as the UK Act) institutes an income tax on the global income earned or received by UK residents and on UK source income earned or received by non-UK residents. Therefore, a CLP provider that is a UK resident may have to include the sales revenue earned from the worldwide sale of goods or services to any CLP customer in their UK income, whereas a non-resident CLP provider may only include CLP sales revenue in their UK income if the revenue is earned solely from UK customers and has a UK source. This provision is similar to that of the income tax provisions applicable in the Act of South Africa where resident CLP providers include their worldwide CLP sales revenue in gross income and non-resident CLP providers may only include sales revenue from a South African source (South African customers) in their South African gross income. Furthermore, the UK Act, much like the Act, imposes income tax obligations solely on the CLP provider for the sales revenue received in the CLP and

completely disregards any benefit that may be received by the customers in the CLP in the form of the CLP rewards.

3.4.2 EMPLOYEE BENEFITS TAX

Section 132 of the UK Act obligates the inclusion of non-cash benefits received under an employment arrangement, known as fringe benefits, in the income of the employee. However, according to the HMRC internal Employment Income Manual 21618 on particular benefits, such as air miles and credit card points, any CLP rewards earned by an employee while using the employer's company card to pay for business expenditure will not be regarded as a fringe benefit and will not be taxed under the UK Act unless the rewards were part of an employment incentive scheme or remuneration package agreed-upon by the employer and employee and further provided that the employer, not the employee, is the customer in the CLP contract in which the rewards are earned (Her Majesty's Revenue and Customs, 2014). If the requirements of Employment Income Manual 21618 are met, the employee will be taxed on the CLP rewards granted to them under an employment contract because the rewards are a fringe benefit on which employment tax may be levied. The Act of South Africa and the Canadian Income Tax Act of 1985 have the similar employment tax implications for the employee with different requirements applicable in each jurisdiction.

3.4.3 DEDUCTIONS FROM TAXABLE INCOME

The HMRC makes provision for deductions of 'allowable expenses' from the income of a taxpayer (United Kingdom Government, Not dated:1). A taxpayer is allowed to deduct any expenditure incurred for the purposes for producing an income in the business that the taxpayer is carrying on (United Kingdom Government, Not dated:1). Accordingly, a CLP provider who is carrying on a business is allowed to deduct the costs incurred to acquire the goods or services that are sold in a CLP sales transaction and incurred for the purposes of producing revenue income in the business of the provider. This provision to allow for the deduction of expenditure incurred in operating the business is similar to the general deduction formula provided in the Act of South Africa, section 8 of the Australian ITAA, and section 18 of the Canadian Income Tax Act of 1985 where CLP providers are able to deduct

costs and expenses incurred to acquire the goods or services that are sold or given to customers in CLP transactions.

3.4.4 VALUE-ADDED TAX

The HMRC levies a consumption tax on the supply of goods or services that is known as VAT and that is levied under the UK's Value-Added Tax Act of 1994 (hereafter referred to as the UK VAT Act). The HMRC levies VAT at a standard rate of 20% on the supply of goods or services in a CLP sales transaction; however, if the goods or services supplied are specifically listed in the UK VAT Act as being supplies that will be taxed at 0%, the provider will levy a VAT of 0% on the supply. CLP rewards are not specifically listed in the UK VAT Act as a 0% supply; however, the goods or services that will be supplied in exchanged for the CLP rewards may be 0% supplies. Due to the unknown nature of the goods or services that will be supplied when the CLP rewards are redeemed in future, the VAT implications on the redemption of the rewards will be deferred to a future stage when the rewards are actually redeemed. The provider will then either levy a 20% or 0% VAT on the value of the goods or services that will be supplied to the customer then. However, some CLPs may include the presence of redemption partners who redeem the rewards of the customer and supply the customer with goods or service in exchange for the rewards/points. The redemption partners would generally levy a 20% or 0% VAT solely on the supply of the goods or services to the customer; however, some CLP providers pay redemption partners a fee for the partnership. According to *HMRC v Aimia Coalition Loyalty UK Ltd.* (2013) CIV 938 (UKSC) and *Customs and Excise Commissioners v Redrow Group plc* (1999) 2 All ER 1(HL), any amount paid by a CLP provider to a loyalty partner or redemption partner is considered to be a consideration paid for a taxable supply in the form of a 'service charge'. The supply was made by the loyalty partner or the redemption partner to the CLP provider, and therefore, VAT has to be levied thereon by the redemption partner in addition to the VAT levied by the partner on the supply of goods or services to the customer in exchange for rewards/points This provision is the most similar out of all jurisdiction comparisons to the VAT Act provisions envisaged under the SARS IN 118 (2021) where the SARS regards a redemption fee paid by the provider to the redemption partner to be consideration paid by the provider for a taxable supply of a service rendered to the provider and on which the

partner has to levy VAT. This supply to the provider is also separate from the supply of goods or services to the customer.

3.4.5 CONCLUSION

The UK tax implications for CLPs are similar to the South African tax implications, especially with reference to the VAT consequences explained in section 3.4.4, the income tax implications in terms of the income tax deduction for expenses incurred by the provider in operating the CLP, and the income fringe benefit tax imposed on employees for CLP rewards employment received by them under an employment contract. The analysis of how CLPs are taxed in the UK are summarised in Table 3.3.

Table 3.3: Summary of the UK CLP tax analysis

	Provider	Customer
Income tax (income/deduction/ employees' benefit tax)	Includes sales revenue earned in the sale of goods or services to the customer as part of the CLP transaction. Also allowed to deduct the cost of the goods and services from income.	Only CLP rewards granted to employees under an employment contract are subject to an employee benefits tax subject to certain requirements
Indirect/consumption tax	Levies VAT on the supply of goods or services to the customer at the initial CLP sale transaction or when the customer redeems the rewards for goods or services that the provider supplies. Pays VAT when receiving a service from the loyalty or redemption partners. The VAT paid is included in the service fee that is charged by the partners for the services (the consideration for the supply) and is not charged and paid separately in addition to the fee.	Pays VAT on goods or services obtained from the provider and upon redemption. The VAT paid is included in the selling price that is charged by the provider for the goods or services (the consideration for the supply) and is not charged and paid separately in addition to the selling price.

Source: Author's own source

3.5 NEW ZEALAND

In New Zealand, CLPs are regarded as tactics used by CLP providers to increase sales revenue through customer loyalty (Incentive Solutions, 2022:1). The taxes imposed by the New Zealand Inland Revenue on CLPs are discussed in the following subsections.

3.5.1 INCOME TAX

According to Part CA 1 of New Zealand's Income Tax Act 97 of 2007, income that is earned by a taxpayer may be included in the taxable income of the taxpayer and be subject to income tax after deducting allowable deductions. The New Zealand authorities considered imposing a direct tax on the benefits received by the customer under a CLP in terms of Part C of Income Tax Act 97 of 2007; however, they concluded under Product Ruling 3 of 2016, that receiving CLP rewards or points in a CLP account is not considered to be income, and therefore, bears no income related tax consequences on the customer (New Zealand Inland Revenue, 2016). Therefore, only the sales revenue earned by the CLP provider when selling goods or services to the customer will be included in the income of the provider and subject to tax after deducting allowable deductions. Furthermore, some employers may remunerate their employees using CLP rewards; however, the provisions of Product Ruling 3 of 2016 will apply to those CLP rewards and will result in the CLP rewards not being subject to income tax in a similar way to the South African and Australian laws.

3.5.2 DEDUCTIONS FROM TAXABLE INCOME

Part DA 1 of Income Tax Act 97 of 2007 allows a taxpayer to deduct an expense incurred or loss suffered to the extent that the expenditure was incurred for the purposes of generating an income for the business carried on by the taxpayer. Therefore, expenditure that is incurred by a CLP provider to acquire goods or services that is sold in order to earn sales revenue under the CLP will be deductible from the total income earned in the provider's business in order to attain the provider's taxable income. This is similar to the general deduction formula provided in the Act of South Africa where CLP providers are able to deduct costs incurred to acquire the goods or services sold to customers in CLP transactions.

3.5.3 GOODS AND SERVICES TAX

The New Zealand authorities established a law that aims to indirectly tax all customers, regardless of employment status, who receive supplies of goods or services under section 9(9) of the Goods and Services Tax Act 141 of 1985 (New Zealand GST). Therefore, CLP providers will levy GST on the goods or services supplied under a CLP sale transaction but

are further allowed to defer the GST to be levied on CLP rewards earned to another person until the benefits/rewards are redeemed provided that:

1. There is an agreement between the CLP provider and the person who will be responsible for levying the GST when the rewards are redeemed for goods or services, such as redemption partner;
2. At least a quarter of the provider's enterprise (or the enterprise of an associated institution) involves the supply of zero-rated goods or services;
3. The provider or associated institution operates a primary business that is not the CLP and the good or service being obtained by the customer when redeeming the rewards is a supply by that primary business; and
4. When the rewards are redeemed, the provider is able to identify when the GST was levied as it relates to the rewards (at issue or deferred to redemption; (Inland Revenue: New Zealand Government, 2009).

In comparison to the provisions under the SARS IN 118 (2021), the SARS imposes VAT on the supply of goods or services by the provider in the CLP transaction where rewards are granted to the customer. Furthermore, the SARS obligates the redemption partner to levy VAT on the goods and services to be supplied to the customer when the customer redeems the CLP rewards for said goods or services. This is similar to how the New Zealand Inland Revenue obligates the provider to levy GST on the initial supply of goods or services and conditionally defer the GST implications of the goods or services to be supplied to the customer when the rewards are redeemed to another person (the person who will be supplying goods or services to the customer in exchange for CLP rewards). Another area where the provisions of the two revenue authorities are similar is that they both require the existence of an agreement between the provider and redemption partner. However, requirement 2 to 4 are not required by the SARS for the levying of VAT in connection to CLP rewards.

3.5.4 CONCLUSION

The New Zealand Inland Revenue authorities levy income tax on providers' sales revenue and grants deductions from the income of the provider in a similar manner to the Act of South Africa. Furthermore, the GST tax implications on CLPs in New Zealand are similar to

the VAT implications of CLPs in South Africa, particularly where the supply of the redemption partner is also subject to the indirect tax. The analysis of New Zealand's taxation of CLPs are summarised in Table 3.4.

Table 3.4: Summary of the New Zealand CLP tax analysis

	Provider	Customer
Income tax (income/deduction/ employees' benefit tax)	Includes sales revenue earned in the sale of goods or services to the customer as part of the CLP transaction. Also allowed to deduct the cost of the goods and services from income.	No income tax imposed on the CLP rewards received by the customer in any capacity.
Indirect/consumption tax	Levies GST on the supply of goods or services to the customer and defers the GST implication of redemption of the rewards to the redemption partner subject to certain conditions.	Pays GST on goods or services obtained from the provider and redemption partner. The GST paid is already included in the selling price that is charged by the provider for the goods or services (the consideration for the supply) and is not charged and paid separately in addition to the selling price.

Source: Author's own design

3.6 UNITED STATES OF AMERICA

Before we assess the tax treatment of CLPs in the USA, we first have to understand what CLPs are in the USA context. A loyalty programme is defined as a tool or strategy used by companies to appreciate the loyalty of their customers and build a strong repeat consumer base by awarding benefits such as vouchers and cashback to their customers (MBA Skool, 2020:1). The tax laws regarding CLPs instituted by the IRS are discussed in the following subsections.

3.6.1 INCOME TAX

The IRS issued Revenue Ruling 4–141 which aims to directly tax the CLP rewards in the hands of and as part of the customer's income (United States of America Internal Revenue Service, 2002). The ruling provides that the value of CLP rewards may be included in the income of the customer and taxable if the rewards were awarded to the customer without the customer incurring any expenses or transacting with the provider in any way, such as purchasing goods or services from the provider, which are usually the case with rewards for

signing onto the CLP, and if the value of the reward is equal to or exceeds US$600. The ruling was further reinforced in *Konstantin Anikeev and Nadezhda Anikeev v* CIR (2021) USA 11 (USATC) (*Anikeev case*) where Konstantin Anikeev, a physicist, who intelligently earned himself a US$300 000 profit by devising a 'rewards currency' complot in which he embarked on a cycle of transactions that eventually saw the value of the CLP rewards/benefits that he earned being deposited into his bank account in the form of cash. The court ruled in Mr Anikeev's favour and established the principle that any benefit obtained from the usage of or activity in CLPs, however inconvenient for the IRS, is not taxable.

Title 26 of the Unites States Internal Revenue Code imposes federal income tax on all incomes earned by USA citizens from all sources (Office of the Law Revision Counsel United States Code, 2022:1). Therefore, the IRS will tax the sales revenue received by provider of CLPs when selling goods or services to customers and on the rewards earned by the customer under the CLP if the customer had not earned the rewards by virtue of incurring expenditure and purchasing goods or services from the provider and if the value of the rewards received by the customer are equal to or exceeds US$600.

Article VI, Clause 2 of the Constitution of the USA (1787) states that federal laws take precedence over any state laws. The US government has not enacted any federal law specifically pertaining to the taxation of CLP rewards that would create compliance obligations for all USA citizens, including companies. Therefore, in accordance with the USA Constitution, each individual state has the constitutional right to enact laws that would be binding to the residents of that state. Only four states have enacted state laws, and therefore, the 46 remaining states solely have the above-mentioned IRS ruling, the *Anikeev case* and Treasury Regulations providing guidance on CLP tax treatment. The only states that have enacted state laws governing the taxation of CLPs are Delaware, New Jersey, Pennsylvania and Minnesota.

In the state of Minnesota, Sales Tax Fact Sheet 167: 'Coupons, Discounts, Rewards, Rebates, and Other Forms of Payment' (Fact Sheet 167) was issued in June 2015 and clarified whether and when a CLP rewards will be subject to sales tax (United States Department of Revenue, 2015:1). According to Fact Sheet 167, CLP rewards will be regarded as purchase discounts and will not be subject to sales tax in the providing company's hands nor the customer's hands if the customer did not:

- Personally, pay an amount of consideration to acquire the reward;
- Render any service to obtain the reward; or
- Cannot redeem the reward for cash and cannot have the reward reimbursed by a third party (United States Department of Revenue, 2015:1).

Conversely, rewards granted under CLPs will not be regarded as discounts and will be subject to sales tax if the customer purchased the reward with cash, rendered services to obtain the rewards, can redeem the rewards for cash or can have the reward reimbursed by a third party (United States Department of Revenue, 2015:1). In the event that rewards received under a CLP has both taxable and non-taxable elements, the entire rewards will be deemed to be taxable unless the provider can provide documentary proof stating otherwise (United States Department of Revenue, 2015:2). Furthermore, Fact Sheet 167 provides that CLPs that grant customers immediate discounts on their current purchases will charge sales tax on the reduced consideration of the purchase much like in South Africa where CLPs such as Shoprite Xtra Savings award customers with instant purchase discounts and only recognise and pay income tax on revenue equal to the discounted purchase price (United States Department of Revenue, 2015:2).

Furthermore, the implementation of Standards Codification 606 (Topic 606) of the Financial Accounting Standards Board (2015), which requires companies to defer revenue attributable to CLP rewards, led to a ruling made by the US Court of Appeals for The Third Circuit in *Giant Eagle Inc v Commissioner of Internal Revenue* (2016) 14-3961 USA (A), which held that the income tax implications associated with the deferred revenue should also be deferred by the company for up to a year under US Revenue Procedure 2004-34 (United States of America Internal Revenue Service, 2004a:2).

The Internal Revenue Code has similar provisions to the Act, which include the inclusion of sales revenue into gross income of the provider (Office of the Law Revision Counsel United States Code, 2022:1). However, the South African constitution does not delegate the enaction of laws to provincial government nor does it defer the income tax implications on revenue earned in CLP sales transactions in correlation to the revenue deferral requirement in IFRS 15. Furthermore, South African tax implications on CLPs are not influenced by the accounting implications like in the USA, and the SARS does not impose income tax on the customer for CLP rewards received by the customer.

3.6.2 DEDUCTIONS FROM TAXABLE INCOME

In Publication 535, the USA government allows US companies an income tax deduction for expenses incurred in the course of producing income (United States of America Internal Revenue Service, 2021:1). This includes the actual costs of the goods or services that the coupon and benefits are going to be redeemed for from total sales. However, CLP benefits do not meet the full criteria of this section to qualify for the deduction (United States of America Internal Revenue Service, 2021:1). This is because of the unknown nature of the goods or services that will be obtained when benefits are redeemed, which results in the cost of this redemption being undeterminable (United States of America Internal Revenue Service, 2004b). However, for companies in the US states of Delaware, New Jersey, and Pennsylvania (the states within the jurisdiction of the Third Circuit), the decision made by the Third Circuit allows them a deduction equal to the cost of the CLP benefits in the year that the customer obtains the benefits (United States of America Internal Revenue Service, 2002). Therefore, USA companies receive a deduction from income for expenses incurred to acquire goods or services sold to the customer in a CLP transaction at a much later stage that corresponds to when the customer redeemed the rewards, which is different to the Act in South Africa in that the Act allows providers to deduct expenditure when it is incurred to acquire the goods or services that the customer will exchange the rewards for and not when the customer actually redeems the rewards.

3.6.3 CONCLUSION

The IRS is similar to the SARS in that the revenue from sales to customers under CLPs will be included in the income of the provider and the expense incurred to acquire those goods or services will be deducted from the income of the provider. The analysis of the USA's taxation of CLPs are summarised in Table 3.5.

Table 3.5: Summary of the USA CLP tax analysis

	Provider	Customer
Income tax (income or deduction)	Sales revenue included in the gross income and may receive an income tax deduction provided that the goods or services being purchased (with cash or with the rewards) can be determined when the deduction is made.	Include CLP rewards received in their income subject to certain conditions.

	Provider	Customer
Indirect/ consumption tax	CLP rewards granted under CLPs will not be regarded as discounts and will be subject to sales tax levied by the provider if the customer purchased the reward with cash, rendered services to obtain the rewards, can redeem the rewards for cash or can have the reward reimbursed by a third party. Conversely, CLPs where the customer did not personally purchase the reward, did not render a service to obtain it, cannot redeem the rewards for cash or have the rewards reimbursed by a third party are considered to be instant sales discounts awarded to the customer. The sales tax on such a transaction is levied on the reduced sales price on the transaction date.	Will pay the sales tax included in the purchase price of the goods or services purchased.

Source: Author's own design

3.7 CONCLUSION

In this chapter, the tax treatment of CLPs in international jurisdictions was analysed. The findings from the analysis of each jurisdiction were compared to other jurisdictions and South Africa to compare and contrast and to identify areas of improvement for South Africa. From the analysis, it can be concluded that there is a general consensus among all six jurisdictions, including South Africa, regarding the following tax implications:

1. The revenue earned by the provider in a CLP transaction will be included in the income of the provider and may be subject to income tax. Furthermore, the expenses incurred by the provider to purchase the goods or services that are provided to the customer in the initial sale and when the rewards are redeemed by the customer will be allowed to be deducted from income and effectively reduce income tax for the provider.
2. The taxing authorities in all jurisdictions obligates the provider and/or the redemption partners to levy a form of indirect tax on the supply of taxable goods or services that are supplied by the provider or partner to the customer when the CLP rewards are exchanged for those goods or services. The indirect tax is levied on the goods or services that will be supplied and not on the CLP rewards or granting or redemption thereof.

However, there are notable differences in the tax treatment of CLPs with regards to the following:

1. The USA is the only jurisdiction that mandates a deferral of the provider's income tax deduction for the expense incurred to acquire the goods or services due to accounting revenue deferral instituted in the Standards Codification 606 (Financial Accounting Standards Board (2015).
2. In the UK, an indirect/consumption tax (called VAT) is further levied on any fees that are paid to the redemption/loyalty partner and are regarded as consideration for a service supplied by the partner to the provider. However, in South Africa, a fee paid by either the provider to the partner or by the partner to the provider is merely a transfer of money and is non-supply for VAT purposes. Furthermore, New Zealand permits the provider to defer the GST implications to the business operator who will redeem the customer's CLP rewards provided there is an agreement between the provider and the business operator, and the latter will redeem the rewards at a future date in exchange for goods or services supplied in the operator's primary business. Moreover, Canada requires that the consideration received from a customer in a CLP sale transaction be apportioned between the goods or services supplied to the customer and the rewards granted the customer in the same transaction. This is because the CRA regards the rewards as an additional supply of a promotional service by the provider to the taxpayer on which GST has to be levied. Contrastingly, Australia, South Africa, and the UK prohibit the apportionment of the consideration received by the provider for the supply goods or services in a sale transaction due to there being only one supply in the CLP sale transaction. Lastly, the USA state of Minnesota imposes sales tax on CLPs in addition to the goods or services supplied in the CLP sale transaction if the customer purchased the reward with cash, rendered services to obtain the rewards, can redeem the rewards for cash, or can have the reward reimbursed by a third party.
3. Canada allows for deductions and in one instance prohibits a deduction for certain expenses paid for using CLP rewards. The CRA states that any donations to charitable bodies, unreimbursed medical expenses incurred after travelling more than 40 kilometres to obtain medical treatment, and contributions to pension funds made using CLP rewards may be deducted from the income of an employee and effectively reduce the employee's income tax. However, any business expenses

paid by CRA employees or parliamentary members using CLP rewards may not be deducted from the income of said employee. Canada is the only jurisdiction that has made these provisions. Therefore, it is recommended that the SARS also make specific provisions to allow for deductions under section 18A for donations made using CLP rewards in a similar manner to the CRA.

4. Only Australia and the USA impose income tax on CLP rewards in the customer's hands. In the USA, Revenue Ruling 4-141 requires the value of CLP rewards to be included in the income of the customer and be taxable if the rewards were awarded to the customer without the customer incurring any expenses or transacting with the provider in any way, such as purchasing goods or services from the provider, which is usually the case with rewards for signing onto the CLP, and if the value of the reward is equal to or exceeds US$600. Conversely, Australia regards the rewards earned by customers for business purposes as ordinary assessable income, which may be subject to income tax. However, flight rewards will only be subject to income tax if they were earned by the customer as part of a service business and as contractual remuneration for the service rendered.
5. South Africa, Australia, Canada and the UK are the only jurisdictions that impose a tax on rewards granted to employees under an employment contract. The tax is called a fringe benefits income tax in South Africa and the UK and is levied on the value of the CLP rewards granted to the employee as remuneration in accordance with an employment contract. In Canada, the tax is imposed on the income of the employee based on the value of the rewards granted under an employment agreement as determined by the employee if the employee is the member of the CLP, or as determined by the employer if the employer is the member of the CLP. However, in Australia, a fringe benefits tax liability is imposed on the employer under the Australian FBTAA and income tax is imposed on the employee for the value of the rewards received by the employee and included in assessable income under the Australian ITAA. However, no fringe benefits tax may be imposed on the employer if arranged under the Australian FBTAA or if the rewards are flight rewards granted to an employee who is a relative of the employer. There are also further instances where CLP rewards will either be included in the assessable income of the customer or taxed as a fringe benefit in the hands on the provider

(not both simultaneously), which will be referred to an official at the ATO to decide whether the rewards will be included in assessable income for the employee or if it will be a fringe benefit liability for the employer. Such instances are when CLP rewards are received by any customer or employee in which the sole commercial purpose of the contract is to award the rewards to the customer or employee or the employer and employee contractually agreed that the rewards would be in lieu of any other remuneration that the employee would have otherwise been entitled to or the rewards are in the form of CLP points and the total accumulated points in the year exceed 250 000 points in Australia.

Table 3.6 is a summary of the comparative analysis of all jurisdictions.

Table 3.6: Summary of the CLP tax implications in the analysed jurisdictions

	South Africa	Australia	Canada	New Zealand	UK	USA
	Tax Implications for the provider					
Sale revenue included in income for original CLP transaction	X	X	X	X	X	X
Deductions allowed for expenses incurred to acquire goods or services upon redemption	X	X	X	X	X	X
Consumption/indirect tax levied on the goods or services supplied to a customer under a CLP	X	X	X	X	X	X
Income tax imposed on the employer for the value of CLP rewards granted to employees under an employment contract		X				
	Tax Implications for the customer					
Inclusion of the value of the CLP rewards earned in income that may be subject to income tax		X				X
Consumption/indirect tax levied on the goods or service supplied to a customer	X	X	X	X	X	X

	South Africa	Australia	Canada	New Zealand	UK	USA
Tax Implications for the provider						
Income tax imposed on the employee for the value of CLP rewards granted to employees under an employment contract	X	X	X		X	
Employee's business travel expenses paid using CLP rewards not allowed as a deduction for income tax purposes			X			
Medical expense income tax deduction for medical expenses paid for using CLP rewards			X			
Donations expense deduction from income tax for donations made to charitable bodies using CLP rewards			X			
Deduction from income tax for contributions made to pension funds using CLP rewards			X			

Source: Author's own design

CHAPTER 4: CONCLUSION AND RECOMMENDATIONS

4.1 INTRODUCTION

As outlined in Chapter 1, CLPs have gained prevalence in various economies and are indicative of a change in the nature of the economic transactions occurring between business and customers in South Africa. Interestingly, research indicates that there has been no change in how these transactions are taxed in South Africa in order to correspond with the change in business (Odendaal & Pidduck, 2014:10; Pidduck & Odendaal, 2013a:1521; Pidduck *et al.*, 2019:627; Swanepoel & Pidduck, 2020:76-77).

In this context, this study was part of a larger study that aimed to quantify the potential tax revenues from the taxation of CLP rewards by customers. This study contributed to this larger study by aiming to determine how CLPs are treated internationally from a tax perspective. In order to achieve the objectives and answer the research question, a doctrinal approach was adopted (described in section 1.6). This chapter concludes on the research question and objective and provides a conclusion for this study.

4.2 ACHIEVEMENT OF THE RESEARCH OBJECTIVES

The following research objectives were pursued in achieving the goal of the larger study:

1. Define the characteristics of a CLP for the purposes of this study that would result in rewards potentially be subject to tax in the hands of the customers under the gross income definition in the Act.
2. Analyse the terms and conditions of the most widely used loyalty programmes in South Africa to determine whether they meet the defining characteristics of a CLP for the purposes of the study.
3. Analyse the annual financial statements of the providers of the selected CLPs in order to quantify the value of the CLP rewards issued to customers.
4. Quantify the cumulative potential tax revenues forgone by the South African fiscus as a result of not taxing CLP rewards.
5. Compare the taxation of CLPs to other jurisdictions using authoritative literature.

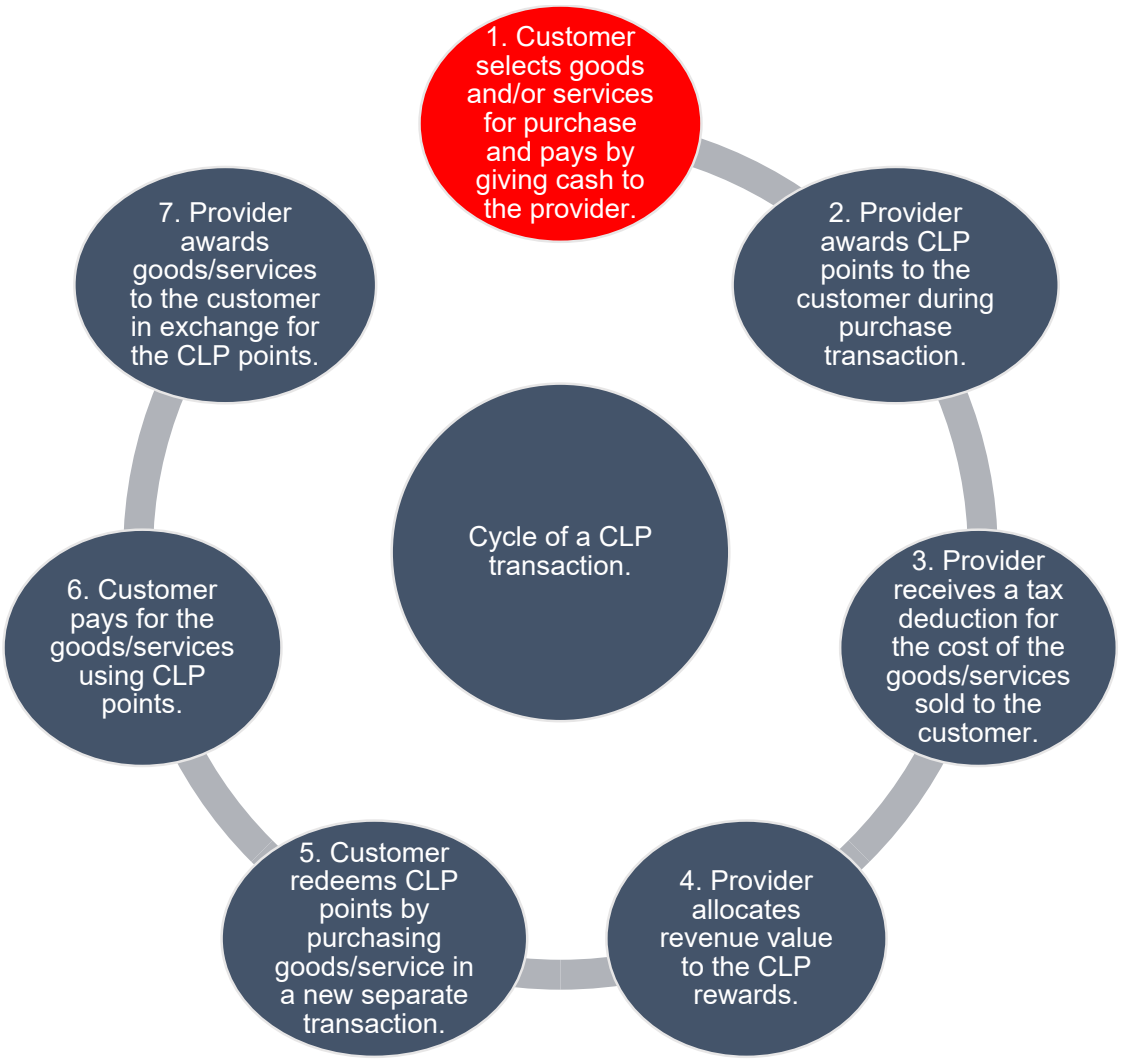
6. Analyse the terms and conditions of the most widely used CLPs in South Africa to determine whether they meet the defining characteristics of the charging section for the purposes of value-added tax (VAT) in South Africa.

The objective of the current study solely focussed on using authoritative literature to compare the taxation of CLPs in international jurisdictions, namely Australia, Canada, New Zealand, the UK and the USA. The selection process for the mentioned jurisdictions is outlined in section 1.6.2. Furthermore, this study was limited in scope to objective 5, and therefore, the findings of this study contribute to the larger study that focussed on objectives 1–4 and 6, which are not addressed in this study. The achievement of the research objective as in this study is discussed individually in the following subsections.

4.2.1 OPERATION OF CLPS

The background and rationale of this study in Chapter 1 introduced CLPs and the impact that they have had in the South African commercial sphere. Chapter 1 further identified the potential positive impact that CLPs may have on the *fiscus* in terms of tax revenue collection. Furthermore, section 2.2 of this study looks at the definition of CLP rewards by the CPA and Chun *et al.* (2020) as an electronic medium of exchange (e-currency) used by customers when acquiring goods or services. This study analysed and discussed the tax implications for basic CLP transactions involving only a provider and customer in which goods or services are purchased by the customer and the provider awards CLP rewards, in addition to the goods or services, that will be used by the customer at a later date. The cycle of the transaction is outlined in Figure 4.1.

Figure 4.1: Cycle of basic CLP transaction



Source: Author's own design (refer to Figure 2.1 in section 2.2)

Moreover, this study analysed a cycle of complex CLP transactions involving the provider, customer, loyalty partners, who award rewards to the customer on behalf of the provider, and redemption partners, who redeem rewards by supplying goods or services to the customer on behalf of the provider. In conclusion, the various features in South African CLPs that follow one of the two mentioned cycles are outlined in section 2.3, and this section includes discussions about whether the rewards have a mobile cellular application specifically dedicated to their CLPs, customers possessing the ability to donate their rewards, and minimum values of a purchase required to earn rewards, to name a few.

Subsequent to defining and analysing the features of basic and complex CLP transactions, the current and prospective South African tax implications of the CLPs were discussed.

4.2.2 TAXATION OF CLPS IN SOUTH AFRICA

Chapter 2 analysed the tax implications of CLPs in South Africa. The analysis included the gross income consequences of CLP rewards in the hands of the customer, fringe benefits for an employee recipient of the rewards, VAT implications for the provider and loyalty and redemption partners in the CLPs, as well as deductions and allowances for the provider under section 11(a) and section 24C of the Act.

Gross Income

In order for CLP rewards to be included in the gross income of a taxpayer customer, it must meet the definition of 'gross income' as stated in section 1 of the Act and as outlined in section 2.7. The element of 'total amount in cash or otherwise' is satisfied as the rewards may either be converted into cash ('total amount in cash') or have an ascertainable monetary value in the form of the future goods or services for which they will be redeemed or in the conversion value placed on the rewards by the provider (refer to section 2.7.1). The total amount must be included in gross income at 'the earlier of receipt or accrual' and the ownership of a CLP card may cause the CLP rewards to be received by or to be accrued to the customer at different times.

If the customer is not obligated to have ownership of the CLP card (refer section 2.7.2.1), the 'received by' element is satisfied at the point when the rewards are granted or awarded to the customer as the ownership of the CLP card is not attached to the accrual or ownership of the CLP rewards. Conversely, if the customer is required to have ownership of the CLP card (refer to section 2.7.2.2), the ownership of the rewards/points may be separated from the ownership of the CLP card, and they are only for customer's 'own behalf and benefit' when redemption occurs. Furthermore, rewards that are donated to charitable organisations by the customer are still considered to have accrued to or been received by the customer before they were donated, and therefore, the rewards are still a taxable benefit in the customer's hands.

There is no definitive test that can be used to determine whether CLP rewards are capital or revenue in nature, and it depends on the intention of the taxpayer. Due to the impracticability of determining the intention of each and every taxpayer, Swanepoel and Pidduck (2020) argue for a special inclusion for CLP rewards in order to override the possibility of the rewards being capital in nature (refer to section 2.7.3). Therefore, all the requirements of the gross income definition could be met should this special inclusion for capital be made.

Fringe Benefits Tax

It is only according to SARS IN 118 (2021) that CLP points or rewards granted under an employment incentive scheme to employees by employers are fringe benefits (non-cash remuneration received by employees from employers) as contained in the Seventh Schedule of the Act, and that the value of the rewards less any consideration paid by the employee to the employer to acquire the benefit will be included in the gross income of the employee under special inclusion paragraph (i) of the gross income definition. However, this provision has not been included in the Act as far as it pertains to CLP rewards (refer to section 2.8. Furthermore, in IN 118, the SARS discusses the multiple stages in CLPs where VAT may be levied.

Value-Added Tax

The South African government also imposes an indirect, consumption tax known as VAT at 15% or 0% on CLPs. SARS has made provisions for VAT to be levied on the parties in a CLP, namely the provider, the customer, and the loyalty and redemption partners in different circumstances under SARS IN 118 (2021). In addition to the normal VAT supply rules for goods or services supplied by the provider, the CLP rewards granted by the provider are taxable goods and the administration of the customer's CLP account is regarded as a taxable service with a taxable value (for the two supplies) equal to zero if no consideration is received specifically for each supply. Therefore, the provider cannot apportion the total consideration received for goods or services purchase by the customer between the said goods/services, the rewards and the administration service. Furthermore, the donation or gratuitous transfer of the rewards and the payment of a participation fee by the partner to the provider or a service fee by the provider to the partner are not supplies. However, the provider or redeemer is required to apply the value of the rewards as a discount against the

supply when the customer redeemed the rewards, and VAT will thereafter be levied on the discounted value. Furthermore, an employer is required to levy VAT on the rewards granted to employees as a fringe benefit. SARS IN 118 indicates that there are multiple VAT implications on CLPs beyond the supply of the goods or services purchased by the customer when the customer earns the rewards and redeems the rewards (refer to section 2.6).

Deduction from Taxable Income

The provider may deduct expenditure incurred using section 11(a) and 23(g) of the Act, which is commonly referred to as the general deduction formula (section 2.4). However, the provider needs to satisfy all the elements of the general deduction formula, which is extensively discussed in section 2.4, to be able to deduct expenses incurred with their CLP. CLP providers satisfy the element of 'carrying on a trade' because they continually and actively operate businesses of buying and selling goods or rendering services for a consideration and with the aim of making a profit (refer to section 2.4.1). Furthermore, providers that operate CLPs voluntarily choose to incur the costs of acquiring goods or services to sell in order to operate their businesses. Therefore, the costs incurred by CLP provider satisfy the requirement of 'expenditure or losses' and are considered to be 'expenditure' and not losses (refer to section 2.4.2). The costs incurred by a CLP provider are considered to be expenditure that has 'actually been incurred' because both parties perform in accordance to the agreement by delivering the goods or services (the supplier) and by paying the purchase price or assuming the obligation to pay the purchase price (the provider). Therefore, if the provider has not paid for the expenditure, the requirement of 'actually incurred' will still be satisfied if the provider assumes the obligation to pay the supplier (refer to section 2.4.3).

The costs incurred by a CLP provider will only be deductible in the year in which all the conditions under the purchase agreement with the supplier have been satisfied (refer to section 2.4.4), and therefore, the condition of deducting the expenditure 'during the relevant year of assessment' is met. Moreover, the expenditure incurred under a CLP to acquire goods or services will be in the production of income as it is to acquire goods or services that will be or that has been sold by the provider to the customer in exchange for non-exempt revenue income. It is closely connected to the income-earning activities (buying and selling goods or services) and is an unavoidable cost of the business (the provider cannot operate

without trading stock) as envisaged by the principles of *Port Elizabeth Electric Tramway Co Ltd v CIR* (1936) 8 SATC 13 (CPD), *Joffe & Co (Pty) Ltd v CIR* (1946) 13 SATC 354 (AD) and *Golden Dumps (Pty) Ltd* (1993) 55 SATC 198 (A) (section 2.4.5).

The expenses incurred by CLP providers do not create an enduring benefit and relate to the income-earning operations and not the structure of the provider, and therefore, the expenditure is considered to be revenue in nature and not capital in nature and may be deducted (refer to section 2.4.6). In conclusion, a CLP provider is able to obtain an income tax deduction for the expenditure incurred to settle the obligation to CLP customers upon redemption of their CLP rewards. This expenditure meets all the requirements of the general deduction formula as it is an expenditure that is actually and unconditionally incurred by the provider while carrying on an income producing trade in a certain year and the expense is not of a capital nature.

Section 24C Future Expenditure Allowance

CLP providers have been prevented from using the section 24C allowance for future expenditure to acquire the goods or services that will be supplied to the customer upon redemption of CLP rewards as a result of *Big G* and *Clicks.* However, these cases revealed that the provider has an obligation to incur expenses even though the section 24C requirements of sameness are not satisfied. Therefore, the provider may be allowed to deduct the expenses incurred under section 11(a) of the Act if the general deduction formula is fully satisfied (refer to section 2.5).

International Comparatives

The tax implications of CLPs in international jurisdictions were analysed in Chapter 3 and are summarised in the following subsections.

Income Tax for The Provider

All jurisdictions, including South Africa, provide that the revenue earned by the provider in a CLP transaction will be included in the income of the provider and may be subject to income tax.

Income Tax for The Customer

Only Australia and the USA impose income tax on CLP rewards in the hands of the customer in the following limited circumstances.

- In the USA, the Revenue Ruling 4-141 requires the value of CLP rewards to be included in the income of the customer and be taxable if the rewards were awarded to the customer without the customer incurring any expenses or transacting with the provider in any way, such as purchasing goods or services from the provider, which is usually the case with rewards for signing onto the CLP, and if the value of the reward is equal to or exceeds US$600.
- In Australia, only rewards earned by customers for business purposes as ordinary assessable income may be subject to income tax. However, flight rewards will only be subject to income tax if they were earned by the customer as part of a service business and as contractual remuneration for the service rendered.

Deductions from Income

All jurisdictions provide that the expenses incurred by the provider to purchase the goods or services that are sold to the customer in the CLP transaction are allowed to be deducted from income and effectively reduce the income tax for the provider. However, the USA mandates a deferral of the provider's income tax deduction for the expense incurred to acquire the goods or services due to accounting revenue deferral instituted in Topic 606 (Financial Accounting Standards Board (2015).

Employee Benefit or Fringe Benefit Tax

South Africa, Australia, Canada and the UK are the only jurisdictions that impose a tax on rewards granted to employees under an employment contract. The tax in South Africa and the UK is levied on the value of the CLP rewards granted to the employee as remuneration in accordance with an employment contract. In Canada, the tax is imposed on the income of the employee based on the value of the rewards granted under an employment agreement as determined by the employee if the employee is the member of the CLP or as determined by the employer if the employer is the member of the CLP.

However, in Australia, a fringe benefits tax liability is imposed on the employer under the Australian FBTAA and income tax is imposed on the employee for the value of the rewards received by the employee and included in assessable income under the Australian ITAA.

However, no fringe benefits tax may be imposed on the employer if arranged under the Australian FBTAA or if the rewards are flight rewards granted to an employee who is a relative of the employer. There are further instances where CLP rewards will either be included in the assessable income of the customer or taxed as a fringe benefit in the hands on the provider (not both simultaneously), which will be referred to an official at the ATO to decide whether the rewards will be included in assessable income for the employee or if it will be a fringe benefit liability for the employer. Such instances are when CLP rewards are received by any customer or employee in which the sole commercial purpose of the contract is to award the rewards to the customer or employee; the employer and employee contractually agreed that the rewards would be in lieu of any other remuneration that the employee would have otherwise been entitled to; or the rewards are in the form of CLP points and the total accumulated points in the year exceed 250 000.

Indirect/Consumption Tax

The taxing authorities in all jurisdictions obligate the provider to levy a form of indirect tax on the consumption of goods or services that are supplied by the provider under the CLP for a consideration in the form of cash or CLP rewards. The customer or recipient of the supplied goods or services would then bear the burden of the tax as the tax is included in the selling price of the goods or services supplied by the provider. However, in South Africa and the UK, an indirect/consumption tax (called VAT in both jurisdictions) is further levied on any fees paid by a loyalty/redemption partner in a CLP. The fee is regarded as consideration of a service supplied by the partner to the provider. Furthermore, New Zealand permits the provider to defer the GST implications to the business operator, who will redeem the customer's CLP rewards provided there is an agreement between the provider and the business operator, and the latter will redeem the rewards at a future date in exchange for goods or services supplied in the operator's primary business. Moreover, Canada requires that the consideration received from a customer in a CLP sale transaction be apportioned between the goods or services supplied to the customer and the rewards granted the customer in the same transaction. This is because the CRA regards the rewards as an additional supply of a promotional service by the provider to the taxpayer on which GST has to be levied. Contrastingly, Australia, South Africa, and the UK prohibit the apportionment of the consideration received by the provider for the supply goods or services in a sale

transaction due to there being only one supply in the CLP sale transaction. Lastly, the US state of Minnesota imposes sales tax on CLPs in addition to the goods or services supplied in the CLP sale transaction if the customer purchased the reward with cash, rendered services to obtain the rewards, can redeem the rewards for cash, or can have the reward reimbursed by a third party.

Other Taxes

Canada allows for deductions and in one instance prohibits a deduction for certain expenses paid for using CLP rewards. The CRA states that any donations to charitable bodies, unreimbursed medical expenses incurred after travelling more than 40 kilometres to obtain medical treatment, and contributions to pension funds made using CLP rewards may be deducted from the income of an employee and effectively reduce the employee's income tax. However, any business expenses paid by CRA employees or parliamentary members using CLP rewards may not be deducted from the income of said employee. Canada is the only jurisdiction that has made these provisions.

The comparative analysis for the different jurisdictions are summarised in Table 4.1.

Table 4.1: Summary of CLP tax implications in the analysed jurisdictions

	South Africa	Australia	Canada	New Zealand	UK	USA
	Tax Implications for the provider					
Sale revenue included in income for original CLP transaction	X	X	X	X	X	X
Deductions allowed for expenses incurred to acquire goods or services upon redemption	X	X	X	X	X	X
Consumption/indirect tax levied on the goods or services supplied to a customer under a CLP	X	X	X	X	X	X
Income tax imposed on the employer for the value of CLP rewards granted to employees under an employment contract		X				
	Tax Implications for the customer					

	South Africa	Australia	Canada	New Zealand	UK	USA
Tax Implications for the provider						
Inclusion of the value of the CLP rewards earned in income that may be subject to income tax (Only in very specific and rare circumstances and when stringent conditions are met)		X				X
Consumption/indirect tax levied on the goods or service supplied to a customer	X	X	X	X	X	X
Income tax imposed on the employee for the value of CLP rewards granted to employees under an employment contract	X	X	X		X	
Employee's business travel expenses paid using CLP rewards not allowed as a deduction for income tax purposes			X			
Medical expense income tax deduction for medical expenses paid for using CLP rewards			X			
Donations expense deduction from income tax for donations made to charitable bodies using CLP rewards			X			
Deduction from income tax for contributions made to pension funds using CLP rewards			X			

Source: Author's own design (refer to Table 3.6 in section 3.7)

Recommendations for South Africa

Based on the comparison performed in section 4.2.3, the following lessons can be used in South Africa to stimulate a tax on CLP rewards:

1. Consider the adoption of the suggestions made by the SARS to include CLP rewards as a special inclusion into gross income in order to override the capital in nature component of the gross income definition (refer to section 2.7.4).
2. Amend the Seventh Schedule of the Act in order to specifically provide for the fringe benefits tax implications of CLP rewards. The only provisions that the SARS has made regarding CLP rewards as fringe benefits are in relation to IN 118 (SARS, 2021) and the VAT deemed supply nature of the fringe benefits under s18(3) of the VAT Act (refer to section 2.8).
3. The SARS may also make specific provisions to allow for deductions under section 18A for donations made using CLP rewards in a similar manner to the CRA (refer to section 3.7).

4.3 SCOPE LIMITATIONS OF THIS STUDY

As discussed in Chapter 1, only a limited number of jurisdictions were analysed, and therefore, it is not feasible to generalise the findings regarding the tax treatment of CLPs globally. The findings of this study find relevancy solely within the analysed jurisdictions, namely South Africa, Australia, Canada, New Zealand, the UK and the USA. Furthermore, this study does not claim to prescribe a final tax treatment for the taxing of CLP rewards in South Africa but rather to provide a basis for the potential tax regime that may be established by the South African taxing authority using lessons from international jurisdictions

4.4 AREAS FOR FUTURE RESEARCH

The following areas have been identified and are recommended for future research:

- A doctrinal legal research analysis of the tax implications relating to CLPs in areas with more geographic and economic similarities and that have similar developmental alliance membership, such as Botswana, Namibia and South Africa.
- A doctrinal legal research analysis and comparison of the tax implications relating to CLPs in South Africa and Nigeria based on the economic competition between the two jurisdictions.

- A study that analyses the operation and the policy behind the laws that govern CLPs in the same jurisdictions analysed in this study but that goes beyond the letter of the law.

4.5 CONCLUSION

This study contributes by using a doctrinal research methodology to analyse the tax treatment of CLPs internationally for both direct and indirect tax from the perspective of the customer and the CLP provider. The findings reveal that although international jurisdictions such as Australia, Canada, New Zealand, UK and USA have made headway with regards to the taxing of CLPs in direct response to their increased prevalence in the commercial environment, the tax provisions established and the administration thereof can be improved. While the research was done on indirect tax (consumption tax levied on the supply of goods or services under a CLP), employee benefits tax (employees taxed on the value of CLP rewards received from employers), and income tax implications for the provider (sales revenue from the CLP transaction is fully included in the income of the provider) relating to CLPs in Australia, Canada, New Zealand, the UK and the USA, it also addressed the tax implications of CLPs in the hand of the customer (the rewards). Simply stated, the existing legislation focuses on taxing flight rewards and employee benefit rewards and is insufficient. Consequently, further research for the taxation of CLPs is necessary in order to contribute to this area of taxation. Therefore, using the findings of this study, South Africa has an opportunity to devise an effective, concise and administratively efficient tax reform regarding CLPs.

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