Progressive tax: A proposal for customer loyalty programmes

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ABSTRACT

Purpose: The South African government needs to increase fiscal revenues to cater to increased government spending. This paper argues that the South African Revenue Service (SARS) has an opportunity to tax the receipt of customer loyalty programme awards in the hands of customers, with little amendment to current tax legislation or administration. This provides the South African government an opportunity to increase much needed tax revenue despite limited resources.

Design/methodology/approach: Five instrumental case studies were used and analysed from a financial reporting perspective in order to quantify customer loyalty points earned by customers. These can form a basis for deriving the potential benefits from the taxation of customer loyalty programmes in the retail industry. The multiple instrumental case studies used and the application of accounting guidance in International Financial Reporting Standards allow generalisations to be made to highlight the amount of customer loyalty awards granted and possible tax revenues forgone in just one sector of the South African economy.

Findings: Should the proposals for taxation of customer loyalty programmes be implemented, the fiscus would be able to collect over R234.35 million (USD 16.91 million) in tax revenue from only five companies providing customers with loyalty awards. This indicates that this proposal for taxation is critical for investigation by the South African government as it may aid in achieving revenue goals for South Africa.

Originality/value: This paper contributes to the literature on taxation legislation within South Africa by proposing a model that may be utilised by the South African Revenue Service to increase tax revenues to meet the government's needs.

Keywords: Customer loyalty programmes, Progressive tax, Income Tax, IFRS, Tax leakage, Revenue Administration

Paper type: Research paper

1. Introduction

Customer loyalty programmes (CLPs) are reward systems that are prevalent across many industries worldwide. To state it briefly, CLPs offer customers incentives to remain loyal to businesses in the form of financial and non-financial awards (Breugelmans *et al.*, 2015; Chinomona and Sandada, 2013). In South Africa, CLPs have been subject to substantial growth rates over the last decade and customers have more than 100 CLPs to choose from (Cromhout, 2016, p.8). The substantial growth in CLPs is due to increased awareness of customer buying behaviour and the impact which favourable incentives have in creating enduring relationships between businesses and customers (Beneke *et al.*, 2015, p.212). Businesses indicate that CLPs offer an opportunity to reduce marketing efforts and expenditure by allowing for the tracking of customer purchasing behaviour and changes in preference (Beneke *et al.*, 2015, p.213). This opportunity translates into increased sales revenue through increased frequency of purchases made by loyal customers (Beneke *et al.*, 2015, p.212; Cromhout, 2016, p.34; Cromhout *et al.*, 2017, p.8).

While it is evident that both customers and businesses are able to derive value from the use of CLPs, these benefits also result in increased economic activity. It follows that any changes in economic activity could be reflected in a change in tax revenues that may be collected by the relevant revenue authorities (Brink, 2014, p.1). In light of this, it is submitted that the benefits derived from the use of CLPs should not only be limited to customers and businesses, but that such benefits could also prove beneficial to the fiscus in the form of additional tax revenues (Pidduck and Odendaal, 2013, p.1532).

Limited research has been performed in determining the possible tax implications on CLPs. In the South African context, businesses are currently able to reduce their taxable income by deducting the costs related to providing these benefits (or reduce taxable income by accounting for cash discounts). However, there is no specific model to tax the receipt of these benefits in the hands of the customer (Agrawal and Lai, 2016; Brink, 2014; Odendaal and Pidduck, 2014; Pidduck and Odendaal, 2013). In light of the disparity between the tax consequences highlighted above, it is submitted that the changes in the relationships between businesses and customers with the use of CLPs has not been suitably addressed by similar changes in fiscal policy.

The basis for this article is to determine if there is a need to amend current tax legislation to cater for a possible tax on the receipt of CLP awards by customers. The authors have identified that the taxation of CLP award credits, in the form of a progressive model, is one area where the broadening of the tax base may be made relatively easy, without requiring onerous legislative or administrative amendments.

The paper consists of six parts. Following this introduction (part one), part two includes a description of the fiscal objectives and the progressive income tax system employed in South Africa. The research methodology employed in the study is then described in part three. Part four describes CLPs within South Africa and analyses the accounting treatment of the CLPs used in the case studies selected. Part five considers the tax implications of these CLPs and includes the description of the proposed model for the implementation of tax on the receipt of CLP awards by customers. Finally, part six consists of the findings and conclusions of the study.

2. Fiscal Objectives and Progressive Tax

The disparity between the tax consequences resulting from CLPs for businesses and customers is reinforced by the fact that businesses are able to deduct the costs related to providing the CLP benefits (or reduce taxable income by accounting for cash discounts), but customers are not taxed on the receipt of these CLP benefits. This disparity is of critical importance in the South African context due to the fact that emphasis has been placed on increasing the tax revenues by growing the tax base and decreasing fiscal leakage. In the 2018 Budget Speech delivered by the Minister of Finance, Malusi Gigaba, it was evident that South Africa had very few options available to increase tax revenue. The methods employed previously included significant increases in personal income tax – particularly at the higher income bands – while it was specifically identified that corporate tax in South Africa is considered high by international standards (National Treasury, 2018b, p. 11). Recent attempts to increase tax revenues have included an increase in the Value Added Tax (VAT) rate from 14% to 15% (National Treasury, 2018b, p.11).

In light of this, it is critical for the South African government to address any fiscal leakages that may be present. Should the receipt of CLP awards by customers be taxed, it may aid in addressing this problem so that the much needed government revenue can be increased.

The current revenue deficit of 4.3% of the Gross Domestic Product (GDP) similarly highlights the need for additional government revenues (National Treasury, 2018b, p.10). In viewing the fiscal policy, the Minister of Finance noted that given the absence of an increase in GDP, if government does not drastically reduce spending, they will continually be faced with difficult budget decisions (National Treasury, 2018a, p.28). Figure 1 below highlights the South African government budget trends as a percentage of GDP from 2008 to 2018:

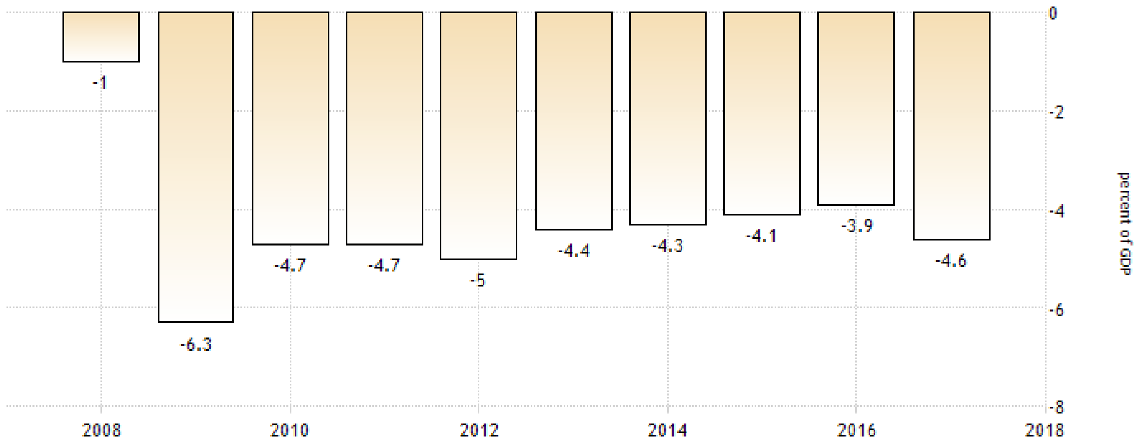

Figure 1: South African government budget (Trading Economics, 2018a)

Increased government spending has contributed to the large revenue deficit and is compounded by attempts by government to reduce poverty and the inequality gap that is prevalent in South Africa (Sisk, 2017). This was supported by the Minister of Finance in the 2018 Budget Speech, when he stated: "Having a sustainable tax base is important to ensure the government has enough revenue to meet its spending needs." (National Treasury, 2018b, p. 12). Poverty and inequality are also major economic concerns which require extensive government spending in the form of redistribution of wealth and social grants in various ways, amongst other things (National Treasury, 2018b, p.31; Ramaphosa, 2018, p.4). Figure 2 illustrates the growth in government spending as reported by Trading Economics (2018b).

Figure 2: South African government spending (Trading Economics, 2018b)

Government revenues are also impacted by economic considerations. Recently, the Commissioner of the South African Revenue Service (SARS) highlighted that despite the growth in the South African economy over the past decade, such growth is slower than that of the average developed economy. He also noted that developed economies are recovering at a rate of 3.6% a year, while South Africa is growing at 0.9% per annum (Moyane, 2017, p.1). These factors indicate that government revenues are under significant pressure which is compounded by prevalent inequality differentials and high unemployment (National Treasury, 2018b, p.6; Ramaphosa, 2018, p.3-4).

Notwithstanding the increases in various forms of tax and levies, SARS collections have been poor and require government to reconsider its current expenditure in order to find a balance between spending and revenue collection initiatives (Brown, 2017). While it is recognised that poor economic growth and high unemployment is a concern for government, tax morality, inefficiencies at the SARS and a small tax base have also has an impact upon poor revenue collections (National Treasury, 2018a, p.10; National Treasury, 2018b, p.12; Ramaphosa, 2018, p.14). However, the Minister of Finance acknowledges that the need to increase the tax base and find new methods of revenue collection is a necessity for the continued growth of the economy and the plans for redistribution of wealth and closing the inequality gap (National Treasury, 2018a, p.29; National Treasury, 2018b, p.10; Ramaphosa, 2018, p.10).

Commentators such as Besley and Persson (2014, p.116) and Bird (2011, p.13) argue that the broadening of the tax base to increase fiscal revenue is a good initiative by government, but that it may lead to a negative outlook depending on the fairness of the national tax policy. This has been evidenced by the often negative commentary on the recent increases in VAT and various other forms of taxes in 2018. Specific arguments have been put forward which indicate that increases in taxes should have limited impact on the poor, disadvantaged, and vulnerable population groups, but should also be managed in a manner that mitigates the risks associated with increased taxpayer non-compliance (Ali *et al.*, 2014, p.828). Increases in taxes are a sensitive topic and commentary by trade unions and civil society highlights the negative consequences that the recent VAT increase has on poor households (Ali *et al.*, 2014, p.839; Speckman, 2018, p.1). Interestingly, Judge Dennis Davis has argued that the VAT increase could have been avoided if corruption had been managed within the state (Speckman, 2018, p.1). Such commentary highlights the sensitivity required in making proposals to amend tax policy that may negatively impact upon the poor.

Previous research has been conducted in terms of the introduction of mechanisms to tax CLP awards. However, the proposals for a tax on CLP awards received were heavily influenced by the resource constraints experienced by SARS (Odendaal and Pidduck, 2014, p.13; Pidduck and Odendaal, 2013, p.1522). In light of these considerations Pidduck and Odendaal (2013 and 2014) proposed a flat rate of withholding tax to be applied to CLP awards in order to capitalise on existing mechanisms available to SARS. Since this research was performed, the loss of necessary resources experienced by SARS has come to the fore, where commentators such as previous Minister of Finance, Pravin Gordhan, have expressed concerns in this regard (Vollgraaff and Vecchiatto, 2017, p.1). The loss of resources in 2017 amounted to 506 skilled employees and it is submitted that this should be taken into consideration in any proposals for the introduction of additional forms of tax (Bornman, 2017, p.1; Moyane, 2017, p.1; Vollgraaff and Vecchiatto, 2017, p.1). Notwithstanding these resource constraints, it is submitted that a failure to address the taxation of CLP awards results in inadvertent tax avoidance by taxpayers, as taxpayers are unaware that CLP awards should be included in gross income, as discussed in part five below. This will contribute to a continued fiscal leakage and undermine the ability of the government to achieve its objectives. However, while the authors agree that a tax on CLP awards should be implemented, as suggested by Odendaal and Pidduck (2014, p. 9), it is submitted that a flat rate of 10% does not consider the fundamental principles embraced in a progressive tax system in its attempt to broaden the tax base.

Progressive tax is the subject of vigorous debate. Promoters of progressive tax argue that international experiences suggest that it is the best way for the fiscus to redistribute wealth and close the inequality gap that is prevalent in South Africa (Jansen and Calitz, 2015, p.2). This is due to the fact that progressive tax provides for a higher tax rate on higher earnings and a lower tax rate on lower earnings (Inchauste *et al.*, 2015). A progressive tax essentially shields poor and vulnerable communities from higher tax burdens while increasing the tax burdens of wealthier individuals (National Treasury, 2018b, p. 12). Other authors argue that while progressive tax may be the best method for the redistribution of wealth, it will result in less disposable income for customers (Inchauste *et al.*, 2015, p.35-36).

South Africa currently employs a progressive tax for personal income tax. The 2018/2019 South African progressive tax tables are included in Table 1 below.

2019 tax year (1 March 2018 – 28 February 2019)	
Taxable income (R)	**Rates of tax (R)**
0 – 195 850	18% of taxable income
195 851 – 305 850	35 253 + 26% of taxable income above 195 850
305 851 – 423 300	63 853 + 31% of taxable income above 305 850
423 301 – 555 600	100 263 + 36% of taxable income above 423 300
555 601 – 708 310	147 891 + 39% of taxable income above 555 600
708 311 – 1 500 000	207 448 + 41% of taxable income above 708 310
1 500 001 and above	532 041 + 45% of taxable income above 1 500 000

Table 1: Tax rates for individuals (SARS, 2018)

Table 1 illustrates the differentials between the various rates of tax applied to individuals for the 2018/2019 year of assessment. It is submitted that a progressive tax on CLPs would assist in broadening the tax base and reduce fiscal leakage while still addressing the wealth inequality faced by South Africans (Sisk, 2017). The risks associated with implementing a tax on CLPs, however, (progressive or otherwise) is that while it should minimise the tax for the poor, it should be implemented in a manner that is not perceived to be unfair and unjust (Bird, 2013, p.21; Odendaal and Pidduck, 2014; Pidduck and Odendaal, 2013). Should a progressive tax rate be applied to CLPs in a manner which is perceived to be unfair or unjust, it may unintentionally increase the risks of a tax revolt or non-compliance. The Minister of Finance highlighted the imperative to minimise these risks when stating that "tax morality is a crucial component of a healthy democracy. It has taken many years and lots of effort to build the foundation of trust that supports our tax morality" (National Treasury, 2018b, p. 13). In light of these statements, it is submitted that using the current progressive tax system to tax CLPs would have a low impact on the low income earners and would aid in presenting this tax in a way that is consistent with that which is already applied by the fiscus. In this way, it would mitigate the risks of implementing this tax as this tax would not be considered inconsistent with existing policy.

SARS will have the difficult task of implementing any policy changes and it is submitted that any legislative amendments should take cognisance of its resource constraints as far as possible. This is supported by the views of Bird (2013, p.6-21) who notes that such policy changes will only be possible if (a) the changes are based on economic systems that are empirically relevant; (b) the changes are socially acceptable; and (c) the changes are able to be implemented effectively. While taking the above considerations into account, this study proposes that not only should CLP award credits be taxed, but that a progressive tax model should be implemented in order to be aligned with the current tax framework in South Africa. In doing so, this study makes proposals that consider the resource constraints experienced by SARS for the purposes of implementation and administration of a tax on CLP awards received by customers.

3. Methodology and Research Design

This study makes use of a qualitative research paradigm through the use of a multiple instrumental case study (Stake, 2005). A multiple case study is defined as a manner in which a researcher can study and contextualise the happenings of a real-life phenomenon through the examination and exploration of a limited number of events from which generalisations can be made (Yin, 2017, p38; Zainal, 2007). This design was chosen to help the authors make generalisations and identify patterns across the topic for investigation (Creswell, 2007, p.40; Leedy and Ormrod, 2005, p.133-135). These industry-specific cases form a small part of a larger system and provide the researchers with insights into the system as a whole (Gomm *et al.*, 2000, p.99).

By making use of industry case studies, the researchers are able to compare results which will assist in building a theory or proposing generalisations (Leedy and Ormrod, 2005, p.135). These generalisations can then be applied to the fiscal implications that are present in the taxation of CLPs. Therefore, though this study is specific to South Africa, it may provide useful insight for other jurisdictions or countries. The use of a multiple case study design allows for generalisation of results through the replication of findings, rather than through sampling. Replication through pattern-matching helps the researchers to support previous findings and, as such, it increases the credibility of the study (Creswell, 2007, p.40-70; Zainal, 2007).

The study makes use of financial data gathered from various sources, such as documentation, annual financial statements, and publicly available information. As such, the study is reported from a financial angle, allowing for financial implications to be drawn (Nagy Hesse-Biber and Leavy, 2011).

Sampling

CLPs are widespread and are used in various industries including retail, hospitality, banking, financial, and airline industries (Cromhout *et al.*, 2016, p.9). For the purposes of this study, only CLPs used by over 40% of customers surveyed in the Truth Whitepaper on the South African Loyalty Landscape 2017 were selected for use. Figure 3 below illustrates the most-used CLPs in South Africa (Cromhout *et al.*, 2017)

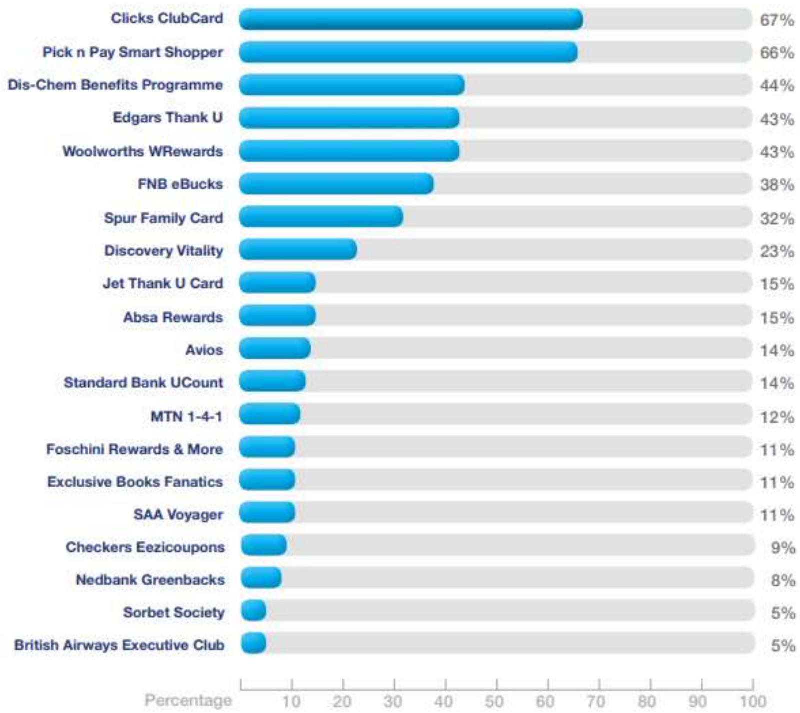

Figure 3: CLP usage within South Africa (Cromhout *et al.*, 2017)

Businesses were further selected on the ability of the researchers to obtain relevant information and financial data from annual financial statements. Therefore, only businesses that reported and disclosed sufficient financial information relating to their CLPs were selected for use. This resulted in five companies being selected for use in this study, namely: Pick n Pay Stores Limited (PnP), Clicks Group Limited (Clicks), Dis-Chem Pharmacies Limited (Dis-Chem), Edgars Stores Limited (Edcon), and Woolworths Supermarkets (Woolworths). The selection of the five case studies has been made to allow the authors to quantify the possible value of tax revenues that may be collected should the model proposed in the study be implemented. The selection of these five case studies suits the aim of the study.

4. Customer Loyalty Programmes in South Africa

Research conducted on the use of CLPs in South Africa indicates that the usage of CLPs in South Africa increased by 8% from 2016 to 2017 (Cromhout *et al.*, 2017, p.2). Of the participants who were surveyed, 79% made use of CLPs (Cromhout *et al.*, 2017, p. 2). In addition to this, Cromhout *et al.* (2016, p.18) found that participation in CLPs amongst South African customers is largely dependent on the amount of personal income earned. An analysis of the findings presented by

Cromhout *et al.* (2016, p.17-20) indicates that wealthier households (earning more income) participate in more CLPs than poorer households who earn less income (Cromhout *et al.*, 2016, p.17-20). Research also indicates that the South African retail industry predominantly makes use of transaction-based CLP award systems (Cromhout, 2016, p.6-23). In light of these factors, it is submitted that any possible tax introduced on CLP awards will have a lower impact on poorer households. It is also submitted that the differentials in participation in CLPs aid in shielding poor communities from a proposed tax on CLPs in alignment with the objectives of a progressive tax system. The following section of the article provides a brief description of the operation of CLPs for retail organisations, for the purpose of understanding how CLP awards are earned, awarded, and accounted for. This description allows the authors to correlate the operation of CLPs with tax and accounting consequences in order to quantify the possible tax revenues which could be collected should CLPs be taxed in accordance with the model proposed in part five.

The operation of CLPs for the cases

The CLPs offered by the cases selected for the study operate in a similar manner. Effectively, upon using their loyalty cards, customers earn loyalty points on qualifying purchases. These accumulated loyalty points can then be redeemed as cashback awards on future purchases.

It is helpful to understand the mechanics of how these CLPs work as well as the accounting treatment thereof, which is prescribed by the International Financial Reporting Interpretation Committee (IFRIC) 13, in order for the authors to attempt to quantify the value of award credits earned by customers.

Accounting Treatment

The accounting treatment for CLPs is currently contained in International Financial Reporting Standard (IFRS) 15: *Revenue from Contracts with Customers* (IFRS 15). However, this standard became effective for financial years beginning on, or after 1 January 2018. None of the cases selected for the purposes of this study adopted IFRS 15 early, for the purposes of its 2017 financial year. In light of this, the accounting treatment relevant to these cases is contained in International Accounting Standard 18: *Revenue* (IAS 18). This accounting standard specifically refers to IFRIC 13: *Customer Loyalty Programmes* to specify the accounting treatment of CLPs. Therefore, IFRIC 13 is considered in determining the accounting treatment of the CLPs in the selected cases for their 2017 financial year.

Briefly, IAS 18 provides that revenue should be recognised when the stated criteria are met and should be measured at the fair value of the consideration which is generated from that sale (IFRS Foundation, 2011a, para. 9 & 14). IFRIC 13 provides further detail for CLP award credits by stating that these award credits need to be accounted for as a separately identifiable component of the sales transaction(s). IFRIC 13 further states that revenue should be recognised when award credits are redeemed and the obligation to supply the awards has been fulfilled (in the case where the award is supplied by the business and not by a third party). Should the CLP award be provided by a third party to the business awarding the CLP award, the accounting treatment would be slightly different. In the cases selected, the majority of, if not all, awards are provided by the business itself, so the accounting treatment of this option is considered.

Per IFRIC 13, in a transaction of sale that provides the customer with a CLP award, an amount of revenue (relating to the CLP award) should be deferred and only recognised once the performance obligation related to providing the award has been satisfied. The amount of revenue to be deferred should be based on the fair value of the award, which takes the fair value of the award into account, as well as the expected forfeiture rate (IFRS Foundation, 2011b).

When customers redeem their CLP awards, the amount of revenue to be recognised (measurement) by the business should be based on the quantity of award credits redeemed, relative to the total award credits that are expected to be redeemed (IFRS Foundation, 2011b, para. 6 & 7). Therefore, any CLP award credits that are unredeemed should be recognised as deferred income until redemption occurs.

This process is diagrammatically represented in Figure 4 below, which contains an illustrative example:

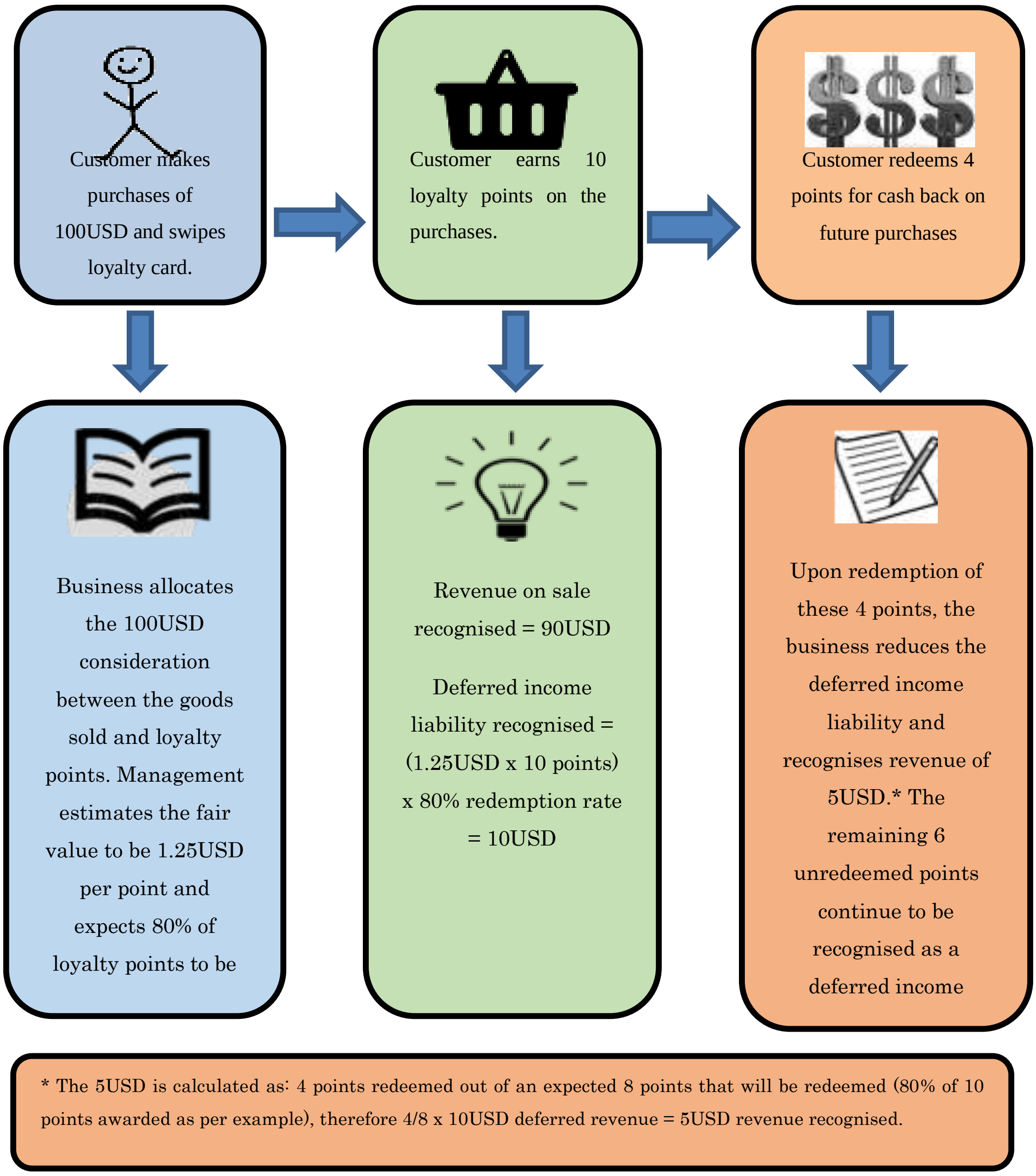

Figure 4: How CLPs operate (Authors' own)

The above accounting treatment was considered in the annual financial statements (AFS) of the cases, where necessary, in order to quantify the value of CLP awards provided to customers for the 2017 financial years. The following section briefly describes the value of these CLP awards for each of the cases selected for use in the study.

Table 2 considers various sources of information to determine the value of CLP awards granted to customers.

Case	Clicks	PnP	Dis-Chem	Edcon	Woolworths
Year-end	31 August 2017	28 February 2017*	28 February 2017*	31 March 2017	30 June 2017
Brief description of CLP	Clicks's CLP, "Clicks ClubCard", allows customers to accumulate Clubcard points that entitle them to vouchers that may be used in store against future purchases (Clicks Group Limited, 2017).	PnP's CLP, "Smart Shopper", rewards customers with Smart Shopper points (award credits) which are effectively used as cash back against future purchases (Pick n Pay Stores Limited Group, 2018).	Dis-Chem's CLP allows retail customers to accumulate points which, subject to certain criteria, may be used in the future in any store in exchange for goods or services (Dis-Chem Pharmacies, 2017).	Edcon's CLP is a loyalty points programme that allows customers to accumulate points when they purchase merchandise. The points can then be redeemed as discounts against merchandise purchases (Edcon Acquisition Proprietary Limited, 2017).	Woolworths's CLP, "WRewards", allows members to save instantly by swiping their Woolworths or MySchool card to save 10% or more on selected items (Woolworths Financial Services (Pty) Ltd, 2018). Customers can also get an extra 5% discount when paying with their Woolworths card.
Information from AFS	Deferred Revenue – CLP: R97.19m.** Expected forfeiture rate: 26% (Clicks Group Limited, 2017)	Deferred Revenue – CLP: R137.4m.** Expected forfeiture rate: 15.9% (Pick n Pay Stores Limited Group, 2018)	Deferred Revenue – CLP: R57.277m.** Expected forfeiture rate: 10-20% (Dis-Chem Pharmacies, 2017)	Loyalty points earned: R195m (Edcon Acquisition Proprietary Limited, 2017). The forfeiture rate was not relevant due to the fact that this entity disclosed the gross amount of the CLP awards made.	No information about CLP deferred income. This is due to the operation of the CLP, where awards are immediately provided upon payment of the purchases and are not deferred to subsequent purchases.
Information from Integrated Report	Total value of CLPs awarded: R322m in cashback awards granted to customers in the 2017 financial year (Clicks Group Limited, 2017).	Total value of CLPs awarded: Not stated	Total value of CLPs awarded: R157m was paid back to CLP members in the 2017 financial year (Dis-Chem Pharmacies, 2017).	It was not necessary to inspect the integrated report of Edcon, as the necessary information (Edcon's CLP loyalty points earned) was disclosed in the AFS.	Total value of CLPs awarded: Not stated
Information from elsewhere	-	-	-	-	"Every year WRewards members receive R100m's in instant savings." (Woolworths Holdings Limited, 2015)

Final conclusion	R322m (USD 23.23m)	R163.4m (best estimate)*** (USD 11.79m)	R157m (USD 11.3m)	R195m (USD 14.07m)	R100m (at least) given the disclosure on the Woolworths website (USD 7.2m)
* Although these entities' 2018 financial AFSs were issued by the time of the manuscript, the relevant 2018 financial year Integrated Report was not yet issued, hence the 2017 financial year numbers were analysed.					
** This represents the fair value of the CLP points not yet redeemed by customers at the companies' financial year-end.					
*** In the absence of disclosure relating to the total value of CLP award credits granted to customers in the PnP case, the authors adjusted the deferred revenue balance by the forfeiture rate in order to determine that at least R163.4m award credits may have been granted to customers in the 2017 financial year.					

Table 2: Summary of CLP information of the cases (Summarised by the authors)

Notwithstanding the guidance provided for the purposes of the accounting treatment of the CLPs, tax implications would arise due to country-specific tax legislation. From a taxation perspective, this does require one to consider that customers participating in CLPs would pay the same on the initial good/service as any other customer not belonging to the CLP. However, a customer belonging to the CLP would receive free/discounted goods or services on future purchases. The next part of the paper considers the tax implications of these CLPs and includes the description of the proposed model for the implementation of tax on the receipt of CLP awards by customers.

5. Taxation of CLPs

The Income Tax Act 58 of 1962 (the Act) is the legislation which governs income tax in South Africa. One of the fiscal principles enshrined in this legislation is the concept that when one taxpayer seeks to claim a deduction (thereby reducing taxable income), another taxpayer will account for the corresponding income (thereby increasing taxable income) (De Koker and Williams, 2018). This results in a balance being achieved from a fiscal perspective. In the context of CLPs in South Africa, when a business incurs costs to provide CLP awards, it is able to deduct these costs in order to determine its taxable income (or reduce taxable income by accounting for cash discounts). However, no mechanism currently exists to account for the corresponding increase in income in the hands of the customer. Therefore, the fiscal balance referred to above is not being achieved in relation to CLPs in South Africa. In light of this problem it is necessary to determine if legislative amendment is required to achieve this balance. For the purposes of this study, a brief discussion of the requisite legislation applicable to the customer is included below.

Taxpayers are taxed on the proportion of their taxable income. A receipt of income is included in the tax computation if it satisfies the requirements of the gross income definition. Gross income is defined in the Act and is used to determine whether or not an amount received should be included for the purposes of calculating taxable income. Section 1 of the Act defines gross income as "the total amount, in cash or otherwise, received by or accrued to or in favour of such resident… excluding receipts or accruals of a capital nature" (National Treasury: Republic of South Africa, 1962).

In determining whether CLPs satisfy the provisions of the gross income definition, the elements of the definition are examined individually below.

Total Amount in Cash or Otherwise

These terms are not defined in the Act; the interpretations provided by the courts are relevant in determining the meaning. These terms were interpreted by Benjamin JJ (p.20) in the case of *WH Lategan v Commissioner for Inland Revenue* (1926) where it was held that these terms indicate that the receipt of an amount or award need not be made in cash, but should have a monetary value. Further, receipts or accruals include every form of property earned, whether corporeal or incorporeal, which has a monetary value (*Commissioner for Inland Revenue v Butcher Bros (Pty) Ltd*, 1944, p. 34; *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*, 1990, p. 21; De Koker and Williams, 2018; *WH*

Lategan v Commissioner for Inland Revenue, 1926, p. 20). It is submitted that CLP awards have a monetary value as they can be redeemed in cash or exchanged for goods or services. In light of this, CLP awards do meet the first element of the gross income definition.

Received by or Accrued to

The terms "received by or accrued to" are also not defined in the Act, and so once again case law has been considered. This term suggests that income may arise in two ways: through the receipt, or accrual of an amount. An amount has been received by a taxpayer when it has been received by the taxpayer for the taxpayer's own benefit, on the taxpayer's own behalf, while an amount has accrued to a taxpayer when the taxpayer has become "unconditionally entitled" to the receipt of that amount (De Koker and Williams, 2018). This is confirmed by the judgement held in the cases of *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* (1990, p. 21) and *Mooi v Secretary for Inland Revenue* (1972).

At this point it is relevant to note that it is not the intention of the legislature that these amounts be included in gross income at both accrual and receipt but rather at the earlier of these dates (*Commissioner for Inland Revenue v Delfos*, 1933; De Koker and Williams, 2018). CLP awards are received and accrued to customers at various points, depending on the type of CLP used. A CLP award will accrue to a customer when the customer is "entitled" to make use of such an award, whereas it will be received by the customer when the customer performs the required action to redeem or exchange the award in line with the relevant CLP rules. In light of this, it is apparent that the CLP awards earned would constitute a receipt or accrual for purposes of the gross income definition and meet the second requirement of the definition of gross income.

Not of a Capital Nature

The term "capital in nature" is also not defined in the Act. This is a fundamental aspect in determining if CLP award credits meet the requirements of the gross income definition. This element of the gross income definition has been interpreted by the courts with reference to the example of a tree and a fruit (*Commissioner for Inland Revenue v Visser*, 1936, p. 276). In this case it is described that income (fruit) is what capital (tree) produces (*Commissioner for Inland Revenue v Visser*, 1936, p. 276). A receipt of a CLP award (income) would constitute the fruit derived from participation in a CLP (capital). It does not produce further income or provide further enduring benefits for the customer, and would not be classified as capital in nature but rather as a revenue receipt.

In light of the above, the receipt of CLP awards meets the definition of gross income for the purposes of computing the taxable income for an individual. Therefore, it is submitted that legislative amendment is not required for the purposes of including the receipt of CLP awards in the taxable income of the customer. Further, any inconsistencies highlighted with regards to the taxation of CLPs do not arise from insufficient tax legislation but rather from insufficient administration in including the receipt of CLP awards in the hands of the customer. SARS is thus lacking in its ability to identify that a receipt of taxable income, in the form of CLP awards, has taken place for the purposes of calculating taxable income.

Implementation of the CLP's taxation proposals

In light of the above discussion, it is evident that the CLP awards provided to customers constitute gross income for the purposes of tax legislation and no specific amendment to the gross income definition is required. Therefore, this gross income should be subjected to income tax, provided that no additional deductions or allowances are awarded. However, any implementation of a tax on CLP awards may be perceived as an additional tax burden by taxpayers and should strive to maintain the integrity of CLPs. In doing so, the tax should not be so burdensome that it is a disincentive for customers to participate in CLPs and that it destroys the value which is derived by customers, businesses, and the fiscus. Similarly, the implementation of this model should not place an onerous administrative burden on SARS to such an extent that such a burden outweighs the benefits of the implementation. It is thus of crucial importance that any mechanism implemented to tax these awards limit the necessity to use significant additional resources. In the next part of the article, a description of the proposed model developed to achieve these objectives is provided.

The Implementation of a Model to tax CLPs

As stated in part two of the paper, South Africa currently employs a progressive tax for personal income tax that is used to address the objectives of the government for the purposes of inequality and redistribution. In light of this, it is proposed that the progressive tax system be maintained for the purposes of taxing the CLP awards. Currently, some of the mechanisms employed to include income into the income of individuals are the use of IRP5s and IT3bs. These forms are used to complete tax returns and are often pre-populated into the tax return of the individual concerned. For purposes of consistency, a similar form (for example, a CLP1 form) could be used for the purposes of recording the value of CLP awards received by customers when completing their tax returns. This would essentially mean that businesses would need to provide customers with one form (CLP1) each year for inclusion in their tax returns. This would allow SARS to identify the CLP awards received by individuals and include the values in each customer's individual return. This would allow the CLP income to be included in the calculation of the taxable income of the individual where the current progressive tax scales can be applied.

The above proposal would have a limited impact upon the current system employed by SARS to capture income, as it uses the mechanisms already in existence to a large extent. It would, however, impact upon the administrative burdens incumbent on businesses, who would be required to provide these forms to the customer and SARS. Businesses would essentially also bear the burden of immediate cash payments to SARS (by paying the withholding tax on behalf of the customers), as opposed to providing a non-cash benefit or a cash benefit that will only be used by the customer at a later stage. Notwithstanding this, CLP statements are not uncommonly provided to customers who wish to identify the value of awards that are due to them. Therefore, the form of these statements would need to be amended and provided on a formal basis to the customer (in the form of a CLP1). It is, however, proposed that these CLP statements (CLP1) be provided electronically to SARS in order to allow for a pre-populated tax return to be generated for the individual. This electronic pre-population is currently used for various aspects of the current system employed by SARS and should not create a significant impediment to the administration requirements for SARS. However, the benefits of the use of the electronic system proposed includes reducing the administrative burden on the customer, while also preventing any non-compliance problems that could occur in a manual system.

Notwithstanding the above, it is submitted that if the proposed system is implemented, it may result in taxpayers' incurring a higher tax liability upon assessment of their tax returns. This is an area of concern as any perceived onerous tax burdens have an impact on the ability of individuals to pay the tax due and may be perceived as unfair. In light of this, it is suggested that a portion of the tax be withheld by the businesses in advance, and paid to SARS. This system is currently employed in many areas of the current tax systems, including various withholding taxes and employee tax. Currently, a rate of 25% is withheld from the balance of remuneration due to part-time or non-standard employment (De Koker and Williams, 2018; Haupt, 2018). Should a similar withholding rate be employed for the purposes of CLP awards, it would aid in alleviating the additional tax liabilities due by individuals upon assessment of their tax returns. This can be illustrated in the following example:

A taxpayer earning R100 in CLP awards would receive R75 in awards while R25 would be paid directly to SARS. If the taxable income for this taxpayer falls within the progressive scale of R195 851 – R305 850 (refer to Table 1 above), the taxpayer would only be required to pay an additional 1% of tax on the CLP awards received. The effect of this would be that taxpayers who are taxed at scales higher than 25% would need to pay in the difference, while those taxed at lower progressive scales would be refunded. The proposed model for the taxation of CLPs can be illustrated as follows:

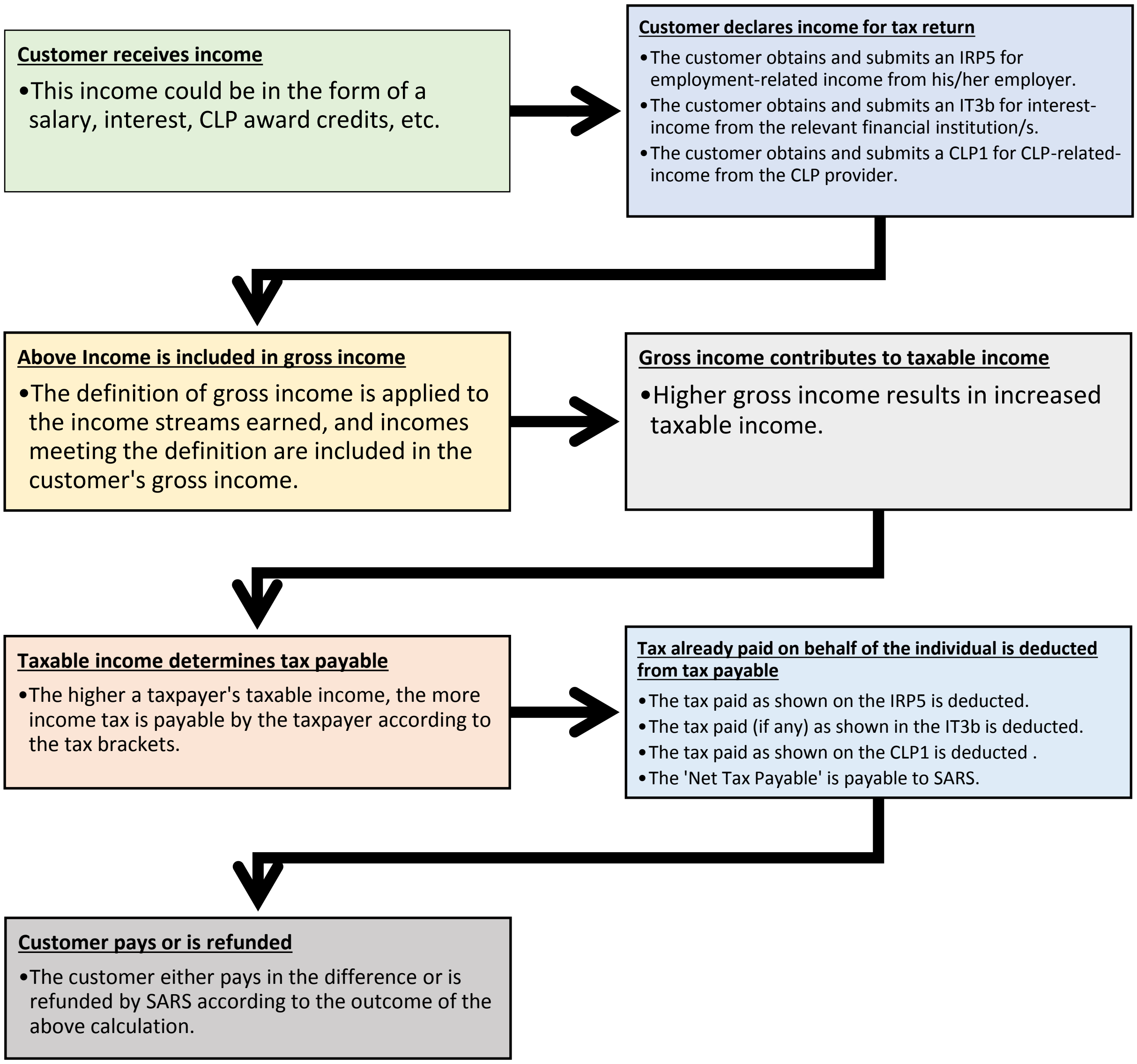

Figure 5: Proposed mechanism for taxation of CLPs (Authors' own)

In applying this model to the cases selected for use in this study, the authors have used the suggested 25% rate on the value of the CLP awards provided to customers (as determined by analysing the accounting for the CLPs offered by the companies (cases) selected). The tax revenues that may be collected by SARS from these cases are calculated as follows:

- Clicks: R322 million x 25% = R80.5 million (USD 5.81 million)
- PnP: R163.4 million x 25% = R40.85 million (USD 2.95 million)
- Dis-Chem: R157 million x 25%= R39.25 million (USD 2.83 million)
- Edcon: R195 million x 25%= R48.75 million (USD 3.52 million)
- Woolworths: R100 million x 25% = R25 million (USD 1.80 million)

In light of this, it is evident that a total of R234.35 million (USD 16.91 million) may be recovered from a tax on CLPs from these five cases. Notwithstanding the above, it may be argued that some taxpayers may be taxed at 18% (the lowest scale on the progressive tax tables listed in Table 1) of the value of the CLP awards granted. Therefore, the value of the tax revenues resulting from a tax on CLPs would be 7% lower than that which has been calculated (if all CLP awards were earned by taxpayers in this scale).

Alternative arguments exist in the case of taxpayers who are taxed at higher levels on the progressive tax tables. Therefore, the possible tax revenues which may be received from these taxpayers could result in up to 20% higher revenues than those calculated above. This alternative argument is supported by the research discussed in part four of this article (Cromhout *et al.*, 2016). As part of this research, it was highlighted that wealthier households participate in more CLPs than poorer households (Cromhout *et al.*, 2016). Therefore, the tax revenues resulting from this tax on CLP awards will have a lower impact on poorer households due to lower levels of participation in CLPs. Notwithstanding this, it may be argued that taxpayers earning a higher taxable income (who are required to pay a shortfall of any progressive scale applied to the CLP awards received) may resist the tax on CLP awards. However, it is submitted that these taxpayers are in a far better position to budget for this shortfall in light of the higher taxable income that they earn. Similarly, the use of the 25% withholding and pre-populated forms will mitigate risk of resistance to a large extent. Therefore, it is submitted that the effective progressive tax rate that may be applied to the CLP awards could result in much greater tax revenue than that calculated above.

The authors are of the opinion that the following benefits from the proposed model may be realised:

- The taxation of CLP awards in this manner allows for progressive tax to be collected, which is consistent with the progressive tax goals of the South African government.
- The proposal primarily makes use of existing structures at SARS and any additional administrative burden is significantly reduced when compared to many other options available for the taxation of CLP awards. Other options considered by the authors were those related to both direct and indirect taxes, including Value Added Tax alternatives, simple gross income inclusion for taxpayers without a withholding tax and taxation at a flat rate of withholding tax.
- Improved cash flow for the government is achieved as at least 25% of the tax on CLPs is received when they are awarded to the customers. Therefore, the fiscus does not need to contend with the delayed receipt of much-needed revenue.
- Customers will have limited exposure to large tax cash outlays upon the submission of their tax returns as 25% of the tax has already been paid.
- Customers will have reduced administrative burdens upon the submission of their tax returns as an electronic, pre-populated system will allow for greater ease in completion of these returns.
- Customers will still be incentivised to participate in the CLPs provided by businesses as customers will still receive awards without highly onerous administrative or cash flow burdens.
- Risks related to non-compliance and possible tax revolt are minimised as perceptions may be managed with greater ease as a result of the use of pre-populated forms indicating the 25% of tax already withheld.

In light of these considerations, it is submitted that the benefits to the fiscus of the taxation of CLP awards, should this model be implemented, would outweigh its burdens.

Notwithstanding the research presented in this paper, the following limitations have been identified:

- The study is based on the South African market and only addresses the tax implications of South African CLPs. Therefore, it may only provide limited use for other jurisdictions. Other developing countries may find this research of greater value if a similar context exists.
- The study is limited to the normal tax implications arising from CLP awards and does not include other types of tax.
- The sampling of the study is also a limitation as only businesses that provided sufficient financial information relating to their CLPs were used. Further, in order to truly reflect the impact on the fiscus it would be necessary to obtain all relevant information about the CLPs of the selected cases. The accounting treatment as discussed in this paper did not allow the authors to obtain all of the internal information from the companies and hence it was not possible to make all possible deductions.

- The study applied IAS 18 and IFRIC 13 to the cases selected as IFRS 15 was not yet effective for the financial data available for the cases selected. It has been identified that, future research on the differences between the accounting treatment of IAS 8 and IFRS 15 may be useful for further studies related the CLP awards. While no formal analysis of IFRS 15 has been performed in terms of the scope of this paper, the authors have identified that the findings are unlikely to differ greatly under the new standard.
- Behaviour of customers and business in response to the introduction of the proposed model has not been analysed in detail. However, in making the proposals for the taxation of CLPs we have considered the administration burden on both customers and businesses as discussed in part five of this paper.
- As only five cases were used, it is difficult to generalise the results to all CLPs that are used in South Africa.

Nonetheless, the authors believe that the value of the additional tax revenue that may be collected from the cases selected outweighs the costs of implementation. Similarly, the tax leakages resulting from not taxing CLP awards are significant. However, future research is required to address other tax implications and jurisdictions which are not included in the scope of this study. The authors have identified that additional research could be performed to address any administrative provisions that may be required, as well as the expiry of non-redeemed points by customers. Similarly, the authors have identified that there may be Value Added Tax and fringe benefit implications for various forms of CLPs in South Africa. Future research related to the behaviour of both customers and businesses to the implementation of a tax on CLP awards will also be of value. During the course of the research the authors identified differences in disclosure of financial information between the cases. Further research on disclosure compliance for CLPs may be valuable for purposes of identifying additional disclosures necessary in the financial statements. Future research will be required to ensure consistency between the various tax doctrines and may expose additional tax revenues that may be collected by SARS.

6. Conclusion

South African tax policy has not kept abreast with changes in the way in which businesses and customers transact. This has resulted in certain forms of income not being taxed in the hands of those who should carry the tax burdens resulting from increased forms of income. This is specifically problematic if one considers that businesses reduce their taxable income when providing these CLP awards. This tax leakage should be of concern to the South African government in light of the much needed tax revenues that are required to achieve its social and economic objectives. The authors proposed a model to tax these CLP awards and identified that significant tax revenues may be recovered for the fiscus should the model be implemented. Should the proposals for taxation of CLPs be implemented, the fiscus may be able to collect over R234.35 million (USD 16.91 million) in tax revenue from only five companies providing customers with loyalty awards. This indicates that it may be a critical area for investigation by the South African government, which may aid in achieving the revenue goals of South Africa. It is noted that while the proposed model employs a progressive tax on CLP awards, it should require a withholding of 25% of this in order to mitigate the risks related to introducing a tax on CLP awards. The authors acknowledge that the implementation of such a tax will inevitably increase the pressure on the resources available to SARS, however, the use of existing structures within SARS reduces this impact. Further, the implementation of a progressive tax will have a low impact on low income earners and is consistent with the progressive tax already employed in South Africa.

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