

# TO TAX OR NOT TO TAX? QUESTIONING CUSTOMER LOYALTY PROGRAMMES

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## **Abstract**

*South Africa, like many other countries, needs additional sources of tax revenues. Recent debate indicates that one potential source of revenue is the taxation of customer loyalty rewards in the hands of customers. The arguments for the taxation of these rewards have been put forward from a principled perspective and not from a legal basis. We argue that while the taxation of these rewards would increase tax revenue, legislative reform is required as there are strong arguments that the rewards are actually not taxable. We suggest tax reforms that attempt to provide certainty and equity in the treatment of such rewards as a whole in order to provide additional revenue for the fiscus.*

## I INTRODUCTION

‘My job is to make the fiscus stronger’,<sup>1</sup> said the Minister of Finance when delivering his ‘Medium term budget policy statement’ in 2018. Notably, the content and title of his speech, ‘The economy at a cross roads’, reflect that weak economic performance and revenue shortfalls have contributed to some slippage in fiscal projections in South Africa.<sup>2</sup> In this context, it is evident that South Africa, like many other countries, needs to broaden and protect its tax base to combat weak economic performance and revenue shortfalls. In an attempt to find additional sources of tax revenue, proposals have been made for taxing customers

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<sup>1</sup> National Treasury: Republic of South Africa, Minister of Finance TT Mboweni, ‘Medium term budget policy statement 2018’ page 12, available at <http://www.treasury.gov.za/documents/mtbps/2018/speech/speech.pdf>, accessed on 18 October 2019.

<sup>2</sup> National Treasury: Republic of South Africa, ‘National budget: Fiscal policy’ page 25, available at <http://www.treasury.gov.za/documents/National%20Budget/2019/review/Chapter%203.pdf>, accessed on 9 October 2019.

on the rewards derived from their participation in customer loyalty programmes (CLPs).<sup>3</sup>

Briefly, a CLP is used by businesses to offer customers incentives to remain loyal. These incentives take the form of financial and non-financial rewards.<sup>4</sup> Interestingly, 75 per cent of customers who are economically active subscribe to CLPs.<sup>5</sup> Growth in the CLP sector has been experienced both locally and internationally,<sup>6</sup> and research indicates that customers have become more discerning and selective than they were in the past about the CLPs to which they subscribe.<sup>7</sup> These CLPs now have the power to change customer behaviour by incentivising customers to work harder toward receiving these rewards.<sup>8</sup>

The above observations regarding the prevalence of CLPs in South Africa have raised questions regarding the taxation of the rewards received by customers.<sup>9</sup> Some authors argue that, while businesses are currently able to reduce their taxable income by deducting the costs related to providing CLP rewards (or to reduce taxable income by accounting for cash discounts), there is no specific model to tax the

<sup>3</sup> Odendaal & Pidduck, 'Avoiding Tax in South Africa's Retail Industry via Customer Loyalty Programs' (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck & Odendaal, 'Customer Loyalty Programmes: The Loss to the Fiscus in South Africa' (2013) 12(12) *International Business and Economics Research Journal* 1521; Pidduck *et al*, 'Progressive Tax: A Proposal for Customer Loyalty Programmes' (2019) 31(4) *Pacific Accounting Review* 626.

<sup>4</sup> Breugelmanns *et al*, 'Advancing Research on Loyalty Programs: A Future Research Agenda' (2015) 26(2) *Marketing Letters* 127 at 129; Consumer Protection Act 68 of 2008; Olivier & Burnstone, 'South African loyalty rewards survey 2014' page 3, available at <http://www.eighty20.co.za/valuenetwork-south-african-loyalty-and-rewards-survey-2014/>, accessed on 18 October 2019; SARS, 2014 'Discussion paper on the VAT treatment of loyalty programmes', available at <https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2014-01%20-%20Discussion%20Paper%20on%20VAT%20Treatment%20of%20Loyalty%20Programmes.pdf>, accessed on 17 October 2019.

<sup>5</sup> Claasen, 'How retailers are cashing in on customer loyalty' page 1, available at <https://www.businesslive.co.za/fm/features/2019-04-04-retailers-cashing-in-on-customer-loyalty/>, accessed on 18 October 2019; Cromhout & Netto, 'South Africa loyalty landscape 2018/9' page 2, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>6</sup> Cromhout *et al*, 'The current state of loyalty in South Africa' page 2, available at [http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB\\_FINAL1.pdf](http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB_FINAL1.pdf), accessed on 11 June 2018.

<sup>7</sup> Cromhout & Netto, 'South Africa loyalty landscape 2018/9' page 5, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>8</sup> Claasen, 'How retailers are cashing in on customer loyalty' page 1, available at <https://www.businesslive.co.za/fm/features/2019-04-04-retailers-cashing-in-on-customer-loyalty/>, accessed on 18 October 2019; Cromhout *et al*, 'Consumer loyalty behaviour in South Africa' page 5, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>9</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521; Pidduck *et al*, (2019) 31(4) *Pacific Accounting Review* 626.

receipt of these CLP rewards in the hands of the customer.<sup>10</sup> In justifying this stance, the referenced authors have adopted a principled approach. Their view is that (for normal tax purposes) a transaction generally results in a deduction for one party to the transaction and an income for the other.<sup>11</sup>

This approach may be broadly explained by means of the following example: A employs B to perform services for an amount of R1 000. In terms of legislation, provided that no exceptions apply, A is allowed to deduct R1 000 in order to calculate taxable income. B would, provided that no exceptions apply, include the R1 000 as income in calculating his or her taxable income.

The argument is simple: whereas one party seeks a deduction for expenditure, the other is required to acknowledge the income. The effect promotes an equitable treatment of transactions from the perspective of the fiscus, as it sees the cumulative effect of the transaction from the perspective of both taxpayers.<sup>12</sup> Nonetheless, in the context of CLP rewards, this 'equity' is not forthcoming and the fiscus sees no corresponding inclusion in the recipient's taxable income.<sup>13</sup> Put differently, one taxpayer (the customer) receives what is argued to be income (in the form of a financial and/or non-financial reward) but is not taxed on the receipt of this reward, yet the company providing this reward is able to deduct the associated costs when it calculates its taxable income. The authors argue that this creates a disparity from the perspective of the fiscus, as these CLP rewards (many of which are non-cash) should be taxed as income in the hands of the recipient. Similar views are expressed by Cohen<sup>14</sup> when he comments on non-cash income: 'To ignore non-cash income is to undermine the fundamental object of income tax, which is not simply to raise revenues, but to apportion the tax burden according to overall economic capacity as measured by income so that those with larger incomes pay more tax.'

<sup>10</sup> Pidduck et al, (2019) 31(4) *Pacific Accounting Review* 626 at 627.

<sup>11</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6 at 7; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521 at 1524.

<sup>12</sup> Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521 at 1524.

<sup>13</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck et al, (2019) 31(4) *Pacific Accounting Review* 626; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521.

<sup>14</sup> Cohen, 'Does Brummeria Sweep Clean? A US Tax-law Perspective' (2009) 126(3) *SALJ* 489 at 489–490.

Attempts have been made to address the disparity by proposing a tax on CLP rewards.<sup>15</sup> Arguably, such rewards satisfy the definition of gross income for purposes of South Africa's tax legislation. Some authors<sup>16</sup> recognise the difficulties that may be experienced in attempting to tax such income and propose a withholding tax as a mechanism to collect much-needed tax revenues.

It is evident that while these researchers<sup>17</sup> propose a tax on the receipt of CLP rewards, their research performs only limited analyses of the legislation (specifically, the definition of gross income) and its application to the terms and conditions of CLPs. The focus of the referenced papers is on quantifying the amount that the fiscus would receive should the proposed withholding taxes be implemented. We submit that the conclusions reached with regards to the Income Tax Act<sup>18</sup> — specifically with reference to the definition of gross income — are flawed, as there is doubt regarding the definition of gross income as applied to the various CLP rewards that customers receive. We address these concerns and highlight alternative arguments that indicate that the receipt of CLP rewards may not meet the requirements of the definition of gross income.

This article provides a detailed analysis<sup>19</sup> of the legislation to determine if CLP rewards, in the hands of the customer, comply with the definition of gross income. Accordingly, our intention is not to focus on quantifying the tax revenues that may be gained from the introduction

<sup>15</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521; Pidduck *et al*, (2019) 31(4) *Pacific Accounting Review* 626.

<sup>16</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521; Pidduck *et al*, (2019) 31(4) *Pacific Accounting Review* 626.

<sup>17</sup> Odendaal & Pidduck, (2014) 2(5) *Journal of Economic and Financial Studies* 6; Pidduck & Odendaal, (2013) 12(12) *International Business and Economics Research Journal* 1521; Pidduck *et al*, (2019) 31(4) *Pacific Accounting Review* 626.

<sup>18</sup> Act 58 of 1962 (the Act).

<sup>19</sup> The doctrinal methodological approach ('black-letter law') employed is a subtle and sophisticated form of legal research that requires a unique blend of both deductive and inductive legal reasoning as described by Salter & Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson/Longman 2007) 113 and Council of Australian Law Deans, 2005 'Statement on the nature of legal research' page 3, available at <https://cald.asn.au/wp-content/uploads/2017/11/cald-statement-on-the-nature-of-legal-research-20051.pdf>, accessed on 27 March 2019. It requires a rigorous analysis, creative synthesis and the making of connections between seemingly disparate doctrinal strands in order to extract principles from an inchoate mass of primary materials. This approach is therefore employed to analyse the legal rules described by Knight & Ruddock, *Advanced Research Methodologies in the Built Environment* (Blackwell 2008) 29 and Pidduck, 'Tax Research Methodology for Untested Legislation: An Exemplar for the Tax Scholar' (2019) 33(3) *South African Journal of Accounting Research* 205 at 210 in order to reach conclusions regarding the interpretation and application thereof to CLP rewards.

of a tax on the receipt of CLP rewards, but rather on the legislation (and accompanying case law) itself. This article suggests legislative reforms that are required should the legislator adopt a tax (via gross income of the customer) on CLP rewards.<sup>20</sup> While it is not practical to analyse individually each CLP operated in South Africa, the purpose of this research is to analyse selected CLPs and make recommendations that may apply more generally.<sup>21</sup>

The article is presented in six parts. Following this introduction (para I), para II commences with a discussion of the process followed to select CLPs used for the analysis. The operation of CLPs in South Africa, including an analysis of the differences between those programmes selected for analysis, is described in para III. Comparative international experiences are discussed in para IV. Para V considers the taxation of CLP rewards received by customers. It focuses specifically on aspects where uncertainty exists and describes the legislative amendments necessary to tax these rewards. Finally, para VI consists of concluding comments.

## II SELECTION OF THE RETAIL SECTOR

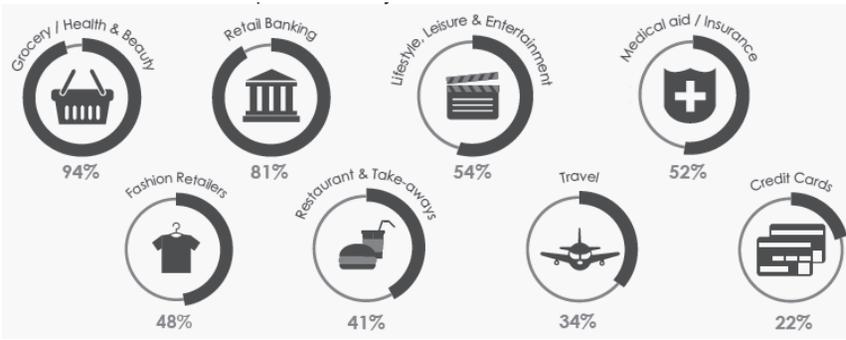
CLPs are widespread and are used in various industries including retail, hospitality, financial services, health and wellness, leisure, airline, and corporate social responsibility.<sup>22</sup> Figure I illustrates the CLP member penetration by sector in South Africa:<sup>23</sup>

<sup>20</sup> This research may also be referred to as reform-oriented. McKerchar, 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation' (2008) 6(1) *eJournal of Tax Research* 5 at 19 is of the opinion that reform-oriented research is designed to accomplish change in the law, and it is that which fosters a more complete understanding of the conceptual bases of legal principles than what non-reform oriented legal research offers. This methodological approach will allow other researchers to review the data objectively and reach the same conclusions as described by McKerchar, 'The study of income tax complexity and unintentional non-compliance: Research method and preliminary findings' Atax Discussion Paper No. 6 page 10, available at <http://dx.doi.org/10.2139/ssrn.623627>, accessed on 2 March 2015.

<sup>21</sup> While generalisations cannot be made for other jurisdictions or sectors, there is an argument that the CLPs selected in the retail sector form part of a larger system and provide insight into the system as a whole as opined by Creswell, *Qualitative Inquiry & Research Design: Choosing Among Five Approaches* (Sage 2007) 40; Gomm et al, *Case Study Method: Key Issues, Key Texts* (Sage 2000) 99 and Leedy & Ormrod, *Practical Research: Planning and Design* (Prentice Hall 2005) 33–135 in commenting on case study research.

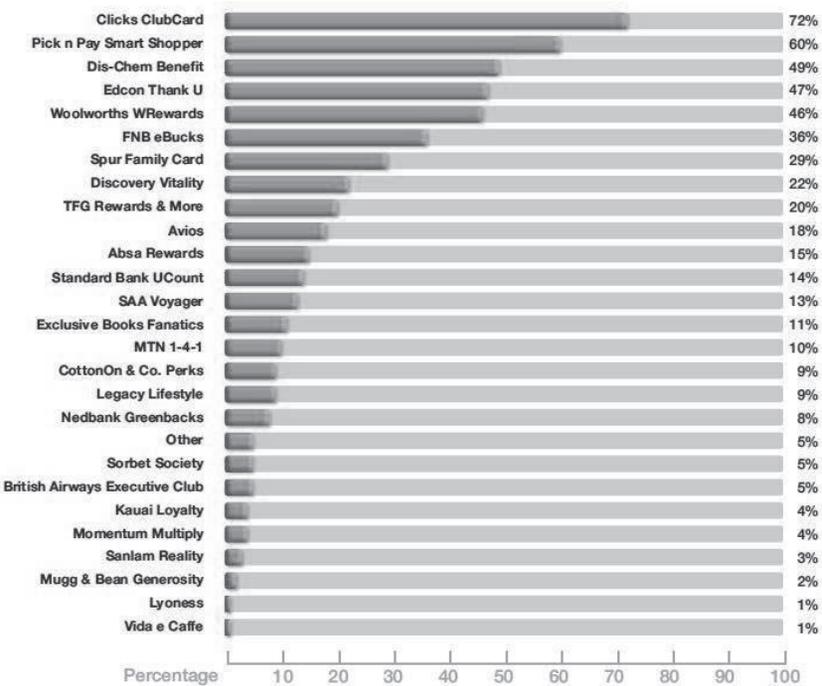
<sup>22</sup> Cromhout et al, 'The current state of loyalty in South Africa' page 9, available at [http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB\\_FINAL1.pdf](http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB_FINAL1.pdf), accessed on 11 June 2018.

<sup>23</sup> Burnstone & Olivier, 'Loyalty programme member engagement survey 2018' page 5, available at <http://www.eighty20.co.za/2018-loyalty-programme-member-engagement-survey/>, accessed on 18 October 2019.



It is evident that the most popular CLPs lie within the traditional retail sector, followed by the financial services sector (specifically retail banking).<sup>24</sup> The focus has been limited to those CLPs and rewards offered in the traditional retail sector.

Figure II illustrates the most-used CLPs in South Africa:<sup>25</sup>



<sup>24</sup> Burnstone & Olivier, ‘Loyalty programme member engagement survey 2018’ page 5, available at <http://www.eighty20.co.za/2018-loyalty-programme-member-engagement-survey/>, accessed on 18 October 2019; Cromhout et al, ‘The current state of loyalty in South Africa’ page 9, available at [http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB\\_FINAL1.pdf](http://truth.co.za/wp-content/uploads/Truth-2016-Loyalty-Whitepaper-WEB_FINAL1.pdf), accessed on 11 June 2018.

<sup>25</sup> Cromhout & Netto, ‘South Africa loyalty landscape 2018/9’ page 7, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

Specific reference has been made to those CLPs that are used by over 40 per cent of the customers surveyed in the Truth white paper on the ‘South African loyalty landscape 2018/9’.<sup>26</sup> Five loyalty programmes are considered for this study: Clicks Clubcard, Pick n Pay Smart Shopper, Dis-Chem Benefit, Edcon Thank U and Woolworths WRewards. These are also the CLPs with the highest active users listed in the Grocery/Health & Beauty Retailer sector in the ‘2018 Loyalty programme member engagement survey’.<sup>27</sup> The authors refer to the operation of these specific CLPs in order to analyse the legal nature of the rewards offered to customers. Though this study is limited to certain forms of CLP rewards in the South African retail sector, it may also provide useful insight for other sectors or jurisdictions.

### III THE OPERATION OF CLPs IN SOUTH AFRICA

The operation of CLPs in South Africa is not homogenous. Burnstone and Olivier<sup>28</sup> assert that the one-dimensional ‘do-this-and-get-that’ CLPs are no longer used and that a more holistic, multifaceted approach is gaining traction. In an earlier study, these authors<sup>29</sup> divide or classify loyalty programmes into two main types. In the first instance, ‘reward programmes’ are those where the member is either entitled to a discount on a current purchase or an allocation of loyalty points that can be used (redeemed) for future purchases, or even used to purchase products and services not normally sold by the owner or sponsor. In addition to these rewards, members may have access to certain privileges that are often linked to relative values or tiers, for example: access to an airport lounge, special checkout queues, preferential access to sales or pre-season events and launches. These reward programmes are therefore linked to specific behaviours, and businesses benefit by receiving sustained levels or shifts in customer behaviour.<sup>30</sup> Secondly, ‘customer clubs’ are defined as structured marketing interventions that offer members a range of

<sup>26</sup> *Ibid.*

<sup>27</sup> Burnstone & Olivier, ‘Loyalty programme member engagement survey 2018’ page 13, available at <http://www.eighty20.co.za/2018-loyalty-programme-member-engagement-survey/>, accessed on 18 October 2019.

<sup>28</sup> Burnstone & Olivier, ‘Loyalty programme member engagement survey 2018’ page 4, available at <http://www.eighty20.co.za/2018-loyalty-programme-member-engagement-survey/>, accessed on 18 October 2019.

<sup>29</sup> Olivier & Burnstone, ‘South African loyalty rewards survey 2014’ page 3, available at <http://www.eighty20.co.za/valuenetnetwork-south-african-loyalty-and-rewards-survey-2014/>, accessed on 18 October 2019.

<sup>30</sup> *Ibid.*

benefits for which a membership fee is charged.<sup>31</sup> These customer clubs do not reward members for specific behaviours, but the focus takes the form of retail discounts, value-added benefits, and/or peace of mind benefits.<sup>32</sup> Therefore, income derived by the business is dependent on subscription fees collected from members.

The focus here is on reward programmes or CLPs that do not charge a membership fee (thus excluding customer clubs) and those that offer future point redemption rather than immediate discounts. Thus, the focus is restricted to those CLPs where customers, upon using their loyalty cards, earn and accumulate loyalty points for redemption as cash back rewards or on future purchases (whether these are from the owner or sponsor or not).<sup>33</sup> An illustrative description of such a CLP is provided in Figure III.

Figure III: Operation of a CLP transaction



Source: Authors' own diagram

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

<sup>33</sup> Maharaj, *Awareness, Perceptions and Effects of Customer Loyalty Programmes Within the Retail Sector of the Durban Metropolitan Area* (unpublished MCom dissertation, University of South Africa, 2008); Rowley, 'Loyalty Kiosks: Making Loyalty Cards Work' (2000) 102(5/6) *British Food Journal* 390.

While each of the CLPs selected for use in this study is underpinned by the same basic design (refer to Figure III above), there are operational and legal aspects or differences that may have an impact on the application of the gross income definition to these CLPs. First, none of the CLPs allows for the exchange of the reward for cash. Second, all of the CLPs provide a point to rand ratio (with the exception of Woolworths WRewards). Third, the terms and conditions for each CLP permit the provider to decline, issue or withdraw the CLP card (and in some instances the points and/or benefits). Lastly, all the CLPs provide for the expiry or suspension of points or rewards (again, with the exception of Woolworths WRewards.) A discussion of some of the distinguishing features of the selected CLPs follows.

*Clicks ClubCard.* One distinguishing feature of this CLP is that only once a customer has spent R250 in a two-month period is a rand value loaded onto the customer's account, but, should a customer spend R1 000 in the same period, the customer is entitled to start earning double points.<sup>34</sup>

*Dis-Chem Benefit Programme.* Interestingly, additional benefits may be received, such as the School Days bursary programme that allows customers 1.6 per cent of their qualifying spend to be attributed to a fund that may be used at registered educational institutions. Additional virtual currency, in the form of FNB eBucks, may also be earned on purchases made by customers who present their eBucks cards at Dis-Chem.<sup>35</sup>

*Edcon Thank U.* Certain restrictions apply in terms of this CLP (for example, in order to redeem points, customers are required to have a minimum balance of 10 000 points), and additional points are available for customers at certain partners (for example, 100 points may be earned for each litre of fuel purchased at participating service stations).<sup>36</sup>

<sup>34</sup> Clicks Retailers (Pty) Ltd operates this in-house CLP and offers customers one CLP point for every R5 spent at Clicks retailers. Each point earned provides an additional ten cents to the customer in cash back. In addition to these points, the CLP offers additional 'feel good' rewards at various reward partners where exclusive benefits and/or more CLP points may be earned at different or accelerated rates. Clicks Group Limited, 'Clicks ClubCard', available at <https://clicks.co.za/clubCardPage>, accessed on 16 October 2019.

<sup>35</sup> Dis-Chem Pharmacies (Pty) Ltd operates this in-house CLP that offers customers points with every purchase, provided that the purchase is at least R10 (the minimum purchase earns 15 points). Customers are also provided with an array of partners to this CLP where additional points may be earned (some at accelerated rates). Dis-Chem Pharmacies Limited, 'Dis-Chem loyalty benefit programme terms and conditions', available at <https://www.dischem.co.za/site-terms-and-conditions>, accessed on 16 October 2019.

<sup>36</sup> The Edcon Thank U CLP is operated by Edcon Limited. Each customer chooses between a cash card and an account card. These cards allow customers to earn ten points for every rand spent (on all-inclusive products) at participating stores or associated partners. Points

*Pick n Pay Smart Shopper.* Customers may switch points for additional value with third party Smart Shopper partners or donate points to charity (for example, customers may switch R40 CLP points for a R50 restaurant voucher). One unique feature of this CLP is that it is the only one that allows others to use or earn the points (typically family of the CLP member).<sup>37</sup>

*Woolworths WRewards.* This programme does not attract points, waiting times or conversions of points to cash but allows customers to earn instant savings or other benefits (dependent on the tier level) from the provider or WRewards partner stores.<sup>38</sup>

An analysis of the terms and conditions related to each of the chosen CLPs indicates that while they may have some common features, there are differences, and some interesting conclusions can be made. First, all five of the CLPs may be classified as ‘reward programmes’ as described by Olivier and Burnstone<sup>39</sup> above. Secondly, none of the programmes are reliant on membership fees as a form of income for the provider. Therefore, no ‘customer clubs’<sup>40</sup> are included in the scope of this study. However, the WRewards programme may be distinguished from the remaining four programmes as it provides immediate discounts or vouchers but does not allow a customer to accumulate CLP rewards in

may be redeemed as a trade discount against cash or account purchases, but there are certain limitations for products that may not qualify for point redemption. In certain instances, customers may also swop their CLP points for goods and/or services outside the group (eg, airtime or data) Edcon Limited, ‘Edcon Thank U terms and conditions’, available at <https://www.thanku.co.za/terms/>, accessed on 16 October 2019; Edcon Limited, ‘Edcon Thank U’, available at <https://www.thanku.co.za/>, accessed on 16 October 2019.

<sup>37</sup> Pick n Pay Stores Limited operates a CLP called Smart Shopper that allows customers to earn points and personalised discounts. Generally, one point is earned for every R2 spent. In addition to this, members are provided with exclusive in-store promotions or Smart Shopper discounts, and purchases at certain partners and/or certain categories of purchase boost the points earned. Members also have the option to switch Smart Shopper points to CLP points at partners (or vice versa). Pick n Pay Retailers (Pty) Ltd, ‘Pick n Pay Smart Shopper’, available at [https://www.pnp.co.za/pnpstorefront/pnp/en/smart-shopper?gclid=EA1aIQobChMIz9uZh92g5QIVjMjeCh3RwQvwEAAAYASAAEgJvxvD\\_BwE](https://www.pnp.co.za/pnpstorefront/pnp/en/smart-shopper?gclid=EA1aIQobChMIz9uZh92g5QIVjMjeCh3RwQvwEAAAYASAAEgJvxvD_BwE), accessed on 16 October 2019; Pick n Pay Retailers (Pty) Ltd, ‘Pick n Pay Smart Shopper terms and conditions’, available at <https://www.pnp.co.za/smart-shopper-t&c>, accessed on 17 October 2019.

<sup>38</sup> WRewards are offered by Woolworths (Pty) Ltd and offer customers instant savings on specially selected items, or vouchers for certain products. However, any payments made with a Woolworths store or credit card attract an additional five per cent off selected items. Woolworths (Pty) Ltd, ‘Woolworths WRewards’, available at <https://www.woolworths.co.za/wrewards/my-wrewards>, accessed on 17 October 2019; Woolworths (Pty) Ltd, ‘Woolworths WRewards terms and conditions’, available at <https://www.woolworths.co.za/wrewards/terms-conditions>, accessed on 17 October 2019.

<sup>39</sup> Olivier & Burnstone, ‘South African loyalty rewards survey 2014’ page 3, available at <http://www.eighty20.co.za/valuenetwork-south-african-loyalty-and-rewards-survey-2014/>, accessed on 18 October 2019.

<sup>40</sup> *Ibid.*

order to use these to make purchases against these rewards or points in future (as depicted in Figure III above). This would explain why it does not provide a point to cash back ratio or provide for the expiry or suspension of points or rewards. In other words, WRewards members receive only a portion of their purchase (a discount) upfront and are still required to pay the total amount charged for the relevant items. This is not the case for the remaining four CLPs as, in all these instances, customers are provided with the opportunity to attain goods or services at a future date by using their points. In light of this, the CLP rewards from the four remaining programmes (excluding WRewards) may be distinguished from discounts (settlement, trade or price discounts) as they are seen as a form of payment and not a discount as considered by the Advertising Regulatory Board,<sup>41</sup> the National Credit Act,<sup>42</sup> or the Consumer Protection Act.<sup>43</sup> For this reason, the WRewards CLP is excluded from the CLP selection for this research.

The next part (para IV) discusses the prominent existing international guidance on CLPs in order to provide context to the analysis as it applies to South Africa in para V.

#### IV COMPARATIVE INTERNATIONAL EXPERIENCE

The analysis of CLPs that follows later in para V is specific to South African tax legislation, but the treatment of the taxation of CLPs in other jurisdictions is important to be able to contextualise the suggestions made in para V. A handful of tax authorities worldwide have issued some sort of guidance or have some form of legislation governing CLPs.

<sup>41</sup> See Advertising Regulatory Board: Code of Advertising Practice section 2 and Appendix C where Clause 7.9.2 in respect of price claims states that where 'price discounts are offered, qualifiers such as "up to", and "xx off" must be presented in easily readable form, and in proximity to the prices quoted'.

<sup>42</sup> National Credit Act 34 of 2005. It is also submitted in this regard that customers are allowed to apply their rewards to future purchases for all four CLPs selected, regardless of participation in credit purchases; rather, their application of their rewards to these future purchases are provided due to their membership of the CLP. Therefore, they are not considered settlement discounts for purposes of this research.

<sup>43</sup> Consumer Protection Act 68 of 2008. Note here that section 34 provides for 'trade coupons and similar promotions' but does not apply to CLPs and this is considered a key difference between discounts and CLP rewards. Furthermore, section 35 considers loyalty credits or awards as 'a legal medium of exchange when offered or tendered as consideration for any goods or services offered, or transaction contemplated, in terms of that loyalty programme'. Consequently, the distinction between sections 34 and 35 indicates a clear distinction between a discount (trade coupons and similar promotions) and a CLP reward (a legal medium of exchange).

In Canada, for example, the guidance around CLPs is confined to that related to employment. The Canadian Revenue Authority<sup>44</sup> states that employees may collect points, such as frequent flyer points or air miles, on their personal credit cards when travelling on business trips but are generally not taxed on the value of such rewards unless certain requirements<sup>45</sup> are met. No mention is made of loyalty points earned outside of an employment context or of those related to traditional retail purchases.

A similar view is taken in the United States of America, where the Internal Revenue Service (IRS) does not seek to tax frequent flyer miles or other promotional benefits obtained by virtue of employment.<sup>46</sup> But, like Canada, this relief does not apply in certain circumstances,<sup>47</sup> and relates only to employment-related frequent flyer miles or other similar promotional benefits, not to those outside of an employment relationship. Interestingly, in September 2019 the IRS proposed a new set of corporate tax rules for providers of CLPs.<sup>48</sup> It is uncertain if a similar proposal relating to personal tax rules for customers who receive CLP rewards will be made in future.

Australia has also made some headway in addressing the taxation of CLP rewards and has relevant case law,<sup>49</sup> a Tax Ruling (TR 1999/6) and a Tax Determination (TD 1999/34).<sup>50</sup> In terms of TD 1999/34 rewards

<sup>44</sup> Canada Revenue Agency: Government of Canada, 'Loyalty and other points programs' available at <https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/gifts-awards-social-events/gifts-awards-outside-policy.html#loyaltyprgms>, accessed on 14 August 2020

<sup>45</sup> These being that the points are converted to cash; the plan or arrangement between the employer and the employee seems to be a form of additional remuneration or the plan or arrangement is a form of tax avoidance

<sup>46</sup> Internal Revenue Service: United States of America, 'Announcement 2002-18: Frequent Flyer Miles Attributable to Business or Official Travel' available at <http://www.irs.gov/pub/irs-drop/a-02-18.pdf>, accessed on 17 August 2020. Also see *Charley v Commissioner Internal Revenue Service* 1996 United States Court of Appeals No. 94-70043 where it was concluded that customer loyalty points that are converted to cash constitute taxable income

<sup>47</sup> These being that the benefits are converted to cash, to compensation that is paid in the form of travel or other promotional benefits, or in other circumstances where these benefits are used for tax avoidance purposes.

<sup>48</sup> The proposed regulations contain examples showing that advance payments for loyalty or rewards points, discount vouchers, airline miles, and other similar arrangements that are treated as separate performance obligations may be eligible for deferral treatment. This proposal is the result of the different treatment of these items for financial statement purposes. See Suttora et al, 'Advance payments for goods and services', available at <https://www.thetaxadviser.com/issues/2020/feb/advance-payments-goods-services.html>, accessed on 18 August 2020

<sup>49</sup> See *Payne v Federal Commissioner of Taxation* 1996 ATC 4407, where the taxpayer's flight rewards, arising as a consequence of employment, did not need to be included in income

<sup>50</sup> TR 1999/6 and TD 1999/34 set out the precedential view of the Australian Taxation Office on whether or not a reward received under a CLP or a flight reward are fringe benefits

received from CLPs arising from private expenditure are not subject to tax.<sup>51</sup> However, there are circumstances where rewards are taxed when they are related to business activities or are fringe benefits as a result of employment.<sup>52</sup>

New Zealand has issued a Product Ruling (BR PRD 16/03) for a specific arrangement<sup>53</sup> dealing with a CLP. In terms of the Product Ruling no income arises for the recipient of the reward even though it is transferred to a saving scheme or account.<sup>54</sup> A subsequent Public Ruling (BR Pub 04/05) provides for circumstances under which fringe benefits are provided by third parties, including CLP rewards.<sup>55</sup> Further, CLP related taxation considerations have been made with regard to Goods and Services Tax.<sup>56</sup> Nevertheless, it seems that no guidance has been provided regarding the taxation of CLP rewards in the hands of customers.

In light of the above, it is evident that whilst some consideration of the taxation of CLP rewards is found internationally, much of this is limited to tax considerations related to that of the provider and not of the customer.<sup>57</sup> Similarly, most research in this area of taxation relates to fringe benefits<sup>58</sup> or even indirect taxes<sup>59</sup> (Goods and Services Tax or

or assessable income. TR 1999/6 relates to flight rewards while TD 1999/34 relates to rewards received from consumer loyalty programmes.

<sup>51</sup> Australian Taxation Office: Australian Government, 'Practice Statement Law Administration 2004/4 GA: Taxing consumer loyalty program rewards' available at <https://www.ato.gov.au/law/view/document?docid=PSR/GA20044/NAT/ATO/00001>, accessed on 18 August 2020.

<sup>52</sup> *Ibid.*

<sup>53</sup> Under an agreement between the Bank and Loyalty New Zealand Limited (Loyalty NZ), members of the Fly Buys loyalty programme will be able to request the redemption of their Fly Buys points for a contribution to their own, or another person's, member's account in the BNZ KiwiSaver Scheme.

<sup>54</sup> Inland Revenue: New Zealand Government, 'Product Ruling—BR PRD 16/03' available at <https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/rulings/product/pd16003.pdf?la=en>, accessed on 18 August 2020.

<sup>55</sup> Inland Revenue: New Zealand Government, 'The provision of benefits by third parties: Fringe benefits tax (FBT) consequences – section CI 2(1)' available at <https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/rulings/public/pu04005.pdf?la=en>, accessed on 18 August 2020.

<sup>56</sup> Where certain loyalty programme operators are allowed to defer the imposition of GST on a sale of loyalty points to another person until such time that the loyalty points are redeemed. Inland Revenue: New Zealand Government, 'GST and Loyalty Points' available at <https://www.taxtechnical.ird.govt.nz/new-legislation/act-articles/2009-34/other-policy-matters/gst-and-loyalty-points>, accessed on 18 August 2020.

<sup>57</sup> In the United Kingdom, see *HMRC v Aimia Coalition Loyalty UK* 2013 (UKSC) 15; Millar, 'Grappling with Basic VAT Concepts in the Australian GST: The Meaning of Supply for Consideration' (2014) 3(1) *World Journal of VAT/GST Law* 1–31.

<sup>58</sup> In Australia, see *Payne v Federal Commissioner of Taxation* 1996 (ATC) 4407; in Canada, see *Mommersteeg et al v The Queen* (1995) 2 CTC 2767.

Value Added Tax<sup>60</sup>) as opposed to the normal tax considerations.

The tax jurisdictions mentioned above certainly provide some useful considerations in relation to CLPs in general, but the South African retail CLPs selected for this study do not find comparatives in these jurisdictions. Stances elsewhere are therefore of limited use in the context of the retail-based CLPs in South Africa. Similarly, while comparative research conducted on the taxation of frequent flyer miles and fringe benefits<sup>61</sup> may be of some use in the South African context, it does not directly address the types of CLPs that are the focus of this article. Clearly, research on the taxation of CLP rewards in the hands of customers is necessary, not only in South Africa but worldwide, and the analysis and suggested reform of domestic legislation in South Africa is a contribution to the discourse in this area of research.

## V TAXATION OF CLPs

The starting point for determining what is taxable in South Africa (before considering exemptions and deductions) is the gross income definition set out in section 1 of the Act. The part relevant for the purposes of this study defines gross income as ‘the total amount, in cash or otherwise, received by or accrued to or in favour of [a taxpayer] . . . excluding receipts or accruals of a capital nature’.<sup>62</sup>

This umbrella definition is followed by a list of ‘special inclusions’ which generally override aspects of the aforementioned definition and, in all cases, override the capital exclusion.<sup>63</sup> This ensures the inclusion of an amount into gross income despite it not meeting all the requirements

<sup>59</sup> In the United Kingdom, see *HMRC v Aimia Coalition Loyalty UK* 2013 (UKSC) 15.

<sup>60</sup> In South Africa a Binding Private Ruling was issued in 2018 dealing with the income tax and VAT consequences of a customer loyalty programme. However, this ruling related to the tax considerations of the applicant (CLP provider) and not the participant. It would accordingly not contribute to the discourse about the taxation of CLP rewards received by a taxpayer but rather about the tax consequences for the provider. South African Revenue Service: Republic of South Africa: ‘Binding Private Ruling: BPR 310’ available at <https://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BPR-2018-23%20-%20BPR%20310%20Customer%20loyalty%20programme.pdf>, accessed on 18 August 2020.

<sup>61</sup> See for example Cunningham, ‘Are Frequent Flyer Benefits Really Benefits: An Analysis of the Frequent Flyer Tax Debate and a New Theory of Taxability for Frequent Flyer Benefits’ (1999) 47 *Cleveland State LR* 281; Canada Revenue Agency: Government of Canada, ‘Loyalty and other points programs’ available at <https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/gifts-awards-social-events/gifts-awards-outside-policy.html#lyltyprgms>, accessed on 14 August 2020; Internal Revenue Service: United States Government, ‘Miles attributable to business or official travel’ available at <https://www.irs.gov/pub/irs-drop/a-02-18.pdf>, accessed on 14 August 2020.

<sup>62</sup> *Ibid.*

<sup>63</sup> *Ibid.*

of the broader definition. None of the special inclusions to date caters for CLPs. Therefore, in order to determine whether CLP amounts should be taxed as gross income in the hands of the recipient, an analysis of each aspect of the definition (and relevant legal precedent) is necessary.

(a) *Total amount in cash or otherwise*

None of the words in the term ‘total amount in cash or otherwise’ is defined in the Act. Seminal case law reveals that the right to a payment in the future that can be monetised constitutes such an amount.<sup>64</sup> Watermeyer CJ held<sup>65</sup> that for something to be an ‘amount’ it must have ‘an ascertainable money value’. In this context, it is evident that CLP rewards may usually be exchanged for cash or goods and services to which a monetary value can easily be attached.<sup>66</sup>

The fact that points often cannot be turned into cash does not mean that the ‘amount’ requirement cannot be met.<sup>67</sup> In fact, a statement by

<sup>64</sup> *Lategan v Commissioner for Inland Revenue* 1926 CPD 203.

<sup>65</sup> *Commissioner for Inland Revenue v Butcher Bros (Pty) Ltd* 13 SATC 21 at 25.

<sup>66</sup> An alternative view could be argued, where the virtual points – and not the goods or services that they are ultimately exchanged for – are the reward. However, even if virtual points were to be seen as the reward, it would, generally, remain a simple process to attach a monetary value to this intangible because CLPs generally readily disclose the points-to-earn conversion ratio. Simple or not, the requirement is only that a money value can be attached; thus, even if a CLP reward system was to create complexity in this regard, it would still constitute an amount for gross income purposes. Evidence for this is found in *Lace Proprietary Mines Ltd v Commissioner for Inland Revenue* 1938 AD 267 at 281.

<sup>67</sup> The transferability (or lack thereof) of the points in some instances creates some interesting considerations. In the case of *Commissioner for Inland Revenue v Delfos* 1933 AD 242 at 251, Wessels CJ found that if something ‘is not money’s worth or cannot be turned into money’, it should not be taxed; that is not to say that it has to be cash, but it must be able to be turned into cash. The ability to tax non-cash items is critical to any tax system and the law is explicit on this issue by the inclusion of the words ‘in cash or otherwise’ in the gross income definition (s 1 of the Income Tax Act defining ‘gross income’). The fiscus was dealt a huge blow in this regard in 1997 when it was held in favour of the taxpayer that where something has no subjective value to the taxpayer, the amount attached to it is zero, as found by Friedman CJ in the case of *Stander v Commissioner for Inland Revenue* 1997 (3) SA 617 (C). Nevertheless, this notion was later swept aside in the controversial ruling delivered by Cloete JA, in *Commissioner for the South African Revenue Service v Brummeria Renaissance (Pty) Ltd & others* [2007] 4 All SA 1338 (SCA), that essentially condoned the taxing of notional interest income and agreed with the state’s contention that the benefit of receiving money interest-free is an amount that can be valued and is thus gross income. This essentially then overturned the *Stander* decision and made it clear that the amount requirement is an objective and not a subjective test. What this means for CLPs is that a strong argument can be made that there is case law precedent for taxing them in the hands of the consumer, even at the stage where they are merely notional rewards and have not been turned into cash, goods or services. Despite the rewards being abstract or notional, it would not be a wild departure from precedent and would indeed constitute a plain language reading of the law to seek to tax these less concrete rewards.

Hefer JA<sup>68</sup> confirmed this view in the *Lategan* case,<sup>69</sup> where he said that it ‘is hardly conceivable that the Legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often reaped from commercial transactions in which money is not the medium of exchange’.

Further support for this view can be found in various cases where shares and share options were seen as meeting the ‘amount’ requirement.<sup>70</sup> It is clear then from the current wording of the Act and related case law that the ‘amount’ requirement is easily met in the case of CLPs despite the points not being considered legal tender or real money.<sup>71</sup> A value can (as it happens, often quite easily) be attached to the points at any stage of the relationship between customer and provider. The appropriate timing in this chain of events is thus further analysed under consideration of the receipt and accrual components of the gross income definition.

*(b) Received by*

For an amount to be received for the purposes of the gross income definition, it has been established from the leading decision dealing with the term<sup>72</sup> that the person also needs to be ‘entitled to’ the amount. Steyn CJ<sup>73</sup> held that ‘actual receipt would be too narrow a condition of chargeability’. He stated that, because the words ‘received by’ are followed by the words ‘accrued to or in favour of’ in the definition of gross income, this offers additional support for the view that the notion of ‘received by’ necessarily implies a right to the amount beyond simply the cash flow from liquidation of whatever the underlying asset might be.<sup>74</sup> Steyn CJ<sup>75</sup> further held that ‘received by’, given its context, has to mean that the amount is received for the person’s ‘own behalf for [the person’s] own benefit’. The issue of ownership was discussed throughout this judgment, but its final role in elucidating the meaning of ‘received by’ is probably best encapsulated in the concurring judgment

<sup>68</sup> *Commissioner for Inland Revenue v People’s Stores (Walvis Bay) (Pty) Ltd* [1990] 4 All SA 594 (A) at 598.

<sup>69</sup> *Lategan* at 208–209.

<sup>70</sup> *Lace Proprietary Mines Ltd; Mooi v Secretary for Inland Revenue* 34 SATC 1; *Ochberg v Commissioner for Inland Revenue* 5 SATC 93.

<sup>71</sup> Sibiya, *The Taxation of Loyalty Programme Rewards: A South African Perspective* (unpublished MCom thesis, University of Johannesburg, 2017) 19.

<sup>72</sup> *Geldenhuis v Commissioner for Inland Revenue* [1947] 3 All SA 379 (C) at 392.

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> At 389.

by Herbstein JA,<sup>76</sup> where he emphasised that receipt without ownership leads to an absurdity in the interpretation of the law. This in turn heralds interesting considerations in relation to CLPs because ownership of the rewards cards vests mostly with the providers. When discussing the concept of an ‘amount’, must the points themselves be considered when analysing the definition of gross income or must one consider the moment when the exchange of points for goods or services occurs as relevant? This earlier discussion of the meaning of ‘amount’ indicates that the points themselves, and not their exchange, are the crucial consideration, but both eventualities, in the context of receipt, are discussed further below.

- (i) *Are the reward points ‘received’ given the caveats around ownership of the cards?* One has to ask whether customers can really be said to have received their points (as envisioned in the gross income definition) when, in truth, the rewards cards do not belong to them. This is further complicated by whether the physical card itself is a requirement for use of the points, or if the points are somehow linked to the customer via, for example, the customer’s phone or ID number. If the physical card is not required, then its ownership is separate from the ownership of the points. But, if the physical card is needed, then there is no legal ownership of the points by the customer and arguably, as a result, there can also not be ‘receipt’ for purposes of the gross income definition at this stage. This in turn means that the point of taxation would be contingent upon the accrual of the reward points (as opposed to the receipt of them). Accrual is discussed separately below.
- (ii) *Are the reward points ‘received’ when they are exchanged for goods or services?* If mere receipt of the points is excluded for gross income purposes due to a lack of ownership, receipt would clearly be at the stage where the points are exchanged for goods or services as it is then that there is something over which the customer has full ownership and control. It has already been established, under the discussion of ‘amount’, that cash does not need to change hands, and, as such, when goods or services are received by the customer for the customer’s own gain, the requirements envisioned by the Act for an amount to be received are plainly met.
- (iii) *Does the transferability of points alter anything?* The transferability of the points could be cause for further concern when considering whether receipt can take place. It seems clear that the points are first

<sup>76</sup> At 390–391.

received by the holder of the card and that the cardholder's subsequent disposal thereof is a separate issue that does not impact the initial receipt (accrual is discussed below).

Despite the potential for complications, these merely impact the 'when' and not the 'if' considerations of receipt, and, therefore, the legislation in its current form already caters for and captures receipt in the case of CLPs. Any proposed reform to the legislation in this regard should clarify the timing issue, thereby ensuring a uniform point of taxation across the various CLPs so that their varied terms and conditions do not create unnecessary complications for revenue collection purposes.

### (c) *Accrual*

In one of the first cases dealing with the meaning of 'accrual', Watermeyer J<sup>77</sup> stated that 'accrued' simply means 'entitled to'. Hefer JA<sup>78</sup> concurred in a subsequent judgment and clarified that an amount need not be both due and payable for it to accrue. The latter notion is supported by the current wording of the proviso to the Act's gross income definition,<sup>79</sup> which reads as follows:

'Provided that where during any year of assessment a person has become entitled to any amount which is payable on a date or dates falling after the last day of such year, that amount shall be deemed to have accrued to the person during such year.'

Similarly, Ogilvie-Thompson CJ<sup>80</sup> stated that, where conditions or contingencies exist that relate to more than a simple delay of ultimately inevitable performance under a contract, there can be no accrual.

The right as bearer of the card to use the points indicates entitlement to the points themselves, despite ownership of the card vesting in the retailer. This means that, as soon as the points are loaded onto the card or become available on the card, accrual to the cardholder has taken place. In his concurring judgment in a recent case, Wallis JA<sup>81</sup> indicated that the retailer (Clicks in this case) has an obligation, where a loyalty card is used at the point of sale, to allocate the concomitant points to the customer. And although this case does not deal with the gross income aspects of CLPs, this statement is nevertheless telling in this context. The

<sup>77</sup> *Lategan* at 209.

<sup>78</sup> *People's Stores (Walvis Bay) (Pty) Ltd* at 601.

<sup>79</sup> Section 1 of the Act *sv* 'gross income'.

<sup>80</sup> *Mooi v Secretary for Inland Revenue* [1972] 2 All SA 57 (A) at 61.

<sup>81</sup> *Commissioner for the South African Revenue Service v Clicks Retailers (Pty) Ltd* 2019 ZASCA 187 para 28.

mere issue of a loyalty card creates no obligation on the retailer to award points. This only arises at the time of the contract of sale of goods, which earns points for accumulation on the card.<sup>82</sup> This in turn implies an equivalent entitlement to the points on the part of the customer and is a strong indicator that accrual takes place at the time of sale, when points are earned, and not only when points are exchanged. Even at this stage, when a retailer becomes obliged to award points, there is not necessarily a concomitant incurral of expenditure on the part of the retailer because the scheme rules could, as happened in the *Clicks* case, require a subminimum number of points before any allocation is made to the customer. The consumer could thus be unconditionally entitled to something that may at that stage have a money value or ‘amount’ (as discussed under part (a) of this section) of zero. What is, however, made clear by recent case law is that income is earned by the retailer under the separate and subsequent contract of sale and not under the loyalty point scheme agreement.<sup>83</sup> The fact that the corresponding income is earned at this point of subsequent sale further underscores that this is also, likely, the point of accrual of the points in the hands of the consumer.

An additional consideration is whether the rules of the specific CLP create conditions that delay accrual until the actual use of the points. The fact that some providers reserve the right to decline, issue or withdraw the card could indicate such a condition. It must, however, be deliberated on as to whether this condition speaks only to the card itself or to the actual attached points balance. The points balance may accrue, with the card merely the mechanism enabling its use. Although it is clear that either receipt or accrual takes place at some point in the exchange between CLP and customer, the potential for complication created by heterogeneous scheme rules needs to be addressed by establishing a uniform point of accrual or receipt upfront.

#### (d) *Capital/revenue*

The test of whether something is capital or revenue in nature has long perplexed both the fiscus and taxpayers. The Act provides no clarification on what is envisioned by the term ‘capital nature’. This has resulted in a deluge of cases over the years. Juristic deliberations on the matter began as far back as 1926<sup>84</sup> and have continued, with the most recent

<sup>82</sup> Paragraph 12.

<sup>83</sup> *CSARS v Big G Restaurants (Pty) Ltd* (157/18) [2018] ZASCA 179 (3 December 2018) para 20; *Clicks* para 9.

<sup>84</sup> *Overseas Trust Corporation Ltd Appellant v Commissioner for Inland Revenue Respondent* 1926 AD 444.

decision in 2016.<sup>85</sup> In fact, the capital/revenue issue was described as being ‘as murky as ever’ as long ago as 1979,<sup>86</sup> and another scholar, decades later, noted: ‘One would have thought that clarity characterises such a basic principle.’<sup>87</sup> Yet, to date, this final consideration of the gross income definition, ‘excluding receipts or accruals of a capital nature’, is perhaps the most controversial. This aspect of the definition is likely to create the most uncertainty in terms of taxation of CLPs, not only because of its equivocal nature, but also because the individual circumstances and intentions of each taxpayer require consideration.

Wessels J<sup>88</sup> noted that income or revenue is born of capital. In a similar vein, Maritz J<sup>89</sup> likened revenue to the fruits of a capital tree:

‘for what is principal or tree in the hands of one man may be interest or fruit in the hands of another. Similarly, law books in the hands of a lawyer are a capital asset in the hands of a bookseller they are a trade asset.’

There can therefore never be a clear answer on the capital/revenue question without considering the context and understanding of the intention of the taxpayer in question. Maritz J<sup>90</sup> cautioned that this stated intention must be treated with a degree of suspicion and be supported by surrounding factors. This is because the classification of a receipt or accrual as capital or revenue in nature is subjective and will vary depending on the taxpayer and therefore must find support in various objective factors that are indicative of the true intention of the taxpayer. The factors worth considering in relation to CLPs are outlined below.

An assessment of the intention of the taxpayer in the case of CLPs appears impractical because the intention of the taxpayer is likely to be merely practical, to collect points and to utilise the benefits CLPs offer.<sup>91</sup> Any tax consequences, specifically the capital/revenue intention, are seldom considered. However, precedent<sup>92</sup> makes it clear that if something is not capital, it must be revenue; therefore, a decision must be reached on which classification applies in any eventuality. Davis AJA<sup>93</sup> clarified that a gain cannot be neither revenue nor capital, it is always one

<sup>85</sup> *Commissioner for the South African Revenue Service v Capstone 556 (Pty) Ltd* [2016] 2 All SA 21 (SCA).

<sup>86</sup> Urquhart, ‘Capital v. Revenue: Some Light in the Darkness’ 1979 *Acta Juridica* 299 at 299.

<sup>87</sup> Olivier, ‘Capital Versus Revenue: Some Guidance’ (2012) 45(1) *De Jure* 172 at 172.

<sup>88</sup> *Commissioner of Taxes v Booysens Estates Ltd* 1918 32 SATC 10 at 15.

<sup>89</sup> *Commissioner for Inland Revenue v Visser* 1937 TPD 77 at 81.

<sup>90</sup> *Ibid.*

<sup>91</sup> Cromhout & Netto, ‘South Africa loyalty landscape 2018/9’ page 29, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>92</sup> *Pyott Ltd v Commissioner for Inland Revenue* 1945 AD 128.

<sup>93</sup> At 135.

or the other. So it is necessary to consider the subjectivity of taxpayer intention when it comes to CLPs.

Consumer reasons for belonging to CLPs do little to clarify whether the prevailing idea behind the collection of points and rewards is capital or revenue in nature.<sup>94</sup> To ascertain this, one needs to turn to the well-established (if, perhaps, vague) tests on whether a scheme of profit-making exists.

This is because the core test of whether something is capital or revenue for gross income purposes is the presence or absence of a scheme of profit-making. This test also demands that intention be considered. Smalberger JA<sup>95</sup> acknowledged this when distinguishing between fortuitous gains (held in this case to be capital in nature) and gains that are purposefully sought and worked for (which would be revenue in nature). He emphasised the objectives of the taxpayer as the strongest determinant in this regard.<sup>96</sup> Wessels JA<sup>97</sup> concurred that there is no conclusive test, but that ‘proof of some special acts which in the ordinary experience of men showed that the taxpayer had conceived some scheme for profit-making and had made it his business to carry it out’ would indicate that such a profit-making endeavour exists.

Holmes JA<sup>98</sup> relied on the 1928 *Stott* judgment to hold that an ‘elaborate and sustained scheme and expertise, was doing much more than merely realising a capital asset to the best advantage in a business-like manner and that by any canons of commerce [the taxpayer] had gone beyond that field: it had crossed the Rubicon and committed itself on a grand scale to the course and business of selling land for profit, using the land as its stock-in-trade’.

The idiom of crossing the Rubicon comes from the historical act of war on the part of Julius Caesar when he crossed a stream that divided Gaul and Italy and indicates of an irreversible and bold decision.<sup>99</sup> But this allusion does not add clarity to an already confusing situation, because it does not easily translate into everyday practical situations, and

<sup>94</sup> Customers ranked their answers as follows: to collect points and receive rewards; to save money; to get exclusive member benefits; to get preferential service; none of the above. Cromhout & Netto, ‘South Africa loyalty landscape 2018/9’ page 29, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>95</sup> *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* [1992] 2 All SA 245 (A) at 263.

<sup>96</sup> Cromhout & Netto, ‘South Africa loyalty landscape 2018/9’ page 29, available at <https://truth.co.za/articles/whitepapers/>, accessed on 9 October 2019.

<sup>97</sup> *Commissioner for Inland Revenue v Stott* (1928) 3 SATC 253 at 262.

<sup>98</sup> *Natal Estates Ltd v Secretary for Inland Revenue* [1975] 4 All SA 375 (A) at 393.

<sup>99</sup> Merriam-Webster.com, ‘Rubicon’, available at <https://www.merriam-webster.com/dictionary/Rubicon>, accessed on 16 October 2019.

it is not always clear where the line is drawn in terms of crossing the divide from capital to revenue or *vice versa*.<sup>100</sup>

It is necessary to contrast the casual CLP user with someone who begins to change his or her behaviour in order to maximise his or her sought-after benefits. Someone who plans shopping around benefits and ensures that he or she shops only at certain partner retailers who provide points for the relevant CLP is starting to show objective signs that he or she is actively working toward a profit or at least toward a personal gain in respect of CLPs. Is the active planner then becoming the bookseller and not the lawyer in the *Visser* analogy outlined above? The answer to that is probably yes, but where exactly to draw the line for an identifiable change in intention, and a crossing of the Rubicon, will always be contentious. The alternative, a simple override of the capital/revenue test, as offered across the board by the special inclusions to the gross income definition, may be necessary.

Corbett CJ<sup>101</sup> held that, given a retired teacher's 'meticulous attention to detail' and that the retired teacher 'manifestly worked for' and 'farmed his [share] portfolio' for profit post-retirement, it was clear that the retired teacher's intent was no longer to solely hold the shares as capital investments. In this regard, the frequency of the retired teacher's share trades was seen as proof of a changed intention.<sup>102</sup> Incidentally, it was anecdotal evidence of active management of CLP engagement by retirees that led the authors to wonder about CLPs in this context. Although this article focuses on select retail CLPs only, are retirees who actively manage several rewards programmes so as to ensure low or no insurance payments, or maximum discounts at their chosen retailers, not involved in a similar exercise to that of *Nussbaum*? Of course, the concept of actively managing CLPs need not be limited to retirees (for example, consider an employee who makes purchases or bookings on behalf of an employer, but ensures personal accumulation of points to the employee's own loyalty cards), but it does shed some light on where the capital/revenue line might be in a CLP context. It could be argued that applying one's mind to, and actively managing one's CLP points, is a scheme of profit-making that produces income no different to Maritz J's<sup>103</sup> description of it 'as the product of a man's wits and energy'.

<sup>100</sup> *Ibid.*

<sup>101</sup> *Commissioner for Inland Revenue v Nussbaum* 58 SATC 283 at 286.

<sup>102</sup> Paragraph 258.

<sup>103</sup> *Visser* at 82.

(e) *Conclusion and recommendations*

‘The problem really calls for a legislative or an administrative (rather than a judicial) solution.’<sup>104</sup>

Although the above comment by Cohen<sup>105</sup> was made in the context of the *Brummeria* ruling, one cannot but think that it applies also to this situation. Should the fiscus want to tax CLPs, the potential for complexities, as seen from the analysis above, shows that the taxation of CLPs is probably best addressed by legislative override in the form of a special inclusion, not in the courtroom where the outcome is uncertain. Our analysis also shows that such an inclusion is not so different from the other special inclusions as to make the idea absurd. It essentially requires the capital/revenue override given to all special inclusions, without extensive concession on the other elements of the definition of gross income.

Perhaps the only thing that requires further thought, for administrative ease, is specifying the time of accrual. Overrides to the timing of accrual can currently be found in many parts of the Act, including, for example, sections 7B and 24M and, therefore, this is also not an unprecedented approach to legislative reform.

The focus here is solely on whether the fiscus could seek to tax CLPs at present, based on current legislation. It appears that the fiscus could potentially do so only in some cases. Furthermore, the proposals for legislative amendment that we have made are to ensure that the receipt of CLP rewards could be taxed as gross income. Therefore, other areas for consideration, beyond the scope of this article, would include: amendments to legislation to address and cater for theft and loss of cards or expiry of points, unilateral changes of points balances on the part of the retailers, to whom amounts should accrue in the case of a primary card with many linked cards, customers who use points for wholesale purchases of trading stock, third party reporting requirements on the part of CLP programmes to supply SARS with the required information, and a withholding tax mechanism to collect the taxes.

## VII CONCLUSION

Participation in CLPs has gained traction internationally in the last decade. This new model of doing business has drawn the attention of those making proposals to tax the rewards received by customers who

<sup>104</sup> Cohen, (2009) 126(3) *SALJ* 489 at 504.

<sup>105</sup> *Ibid.*

participate in these CLPs. Some commentators have argued that legislation already allows for these rewards to be taxed in the hands of customers, in the form of gross income, particularly in South Africa. Nevertheless, this analysis has raised compelling arguments both for and against this view in the South African context. The primary areas of concern relate to specific components of the gross income definition, being the timing of accrual or receipt and the notion of whether or not something is capital in nature. Given the uncertainty that these arguments raise, proposals for the amendment of the gross income definition have been suggested should the legislature seek to impose a tax on CLP rewards. While the research presented in this paper was limited to South Africa, advances in the area of taxation of CLPs internationally have been considered. It is submitted that the experiences of Canada, the United States of America, Australia and New Zealand may be useful for purposes of tax considerations relating to fringe benefits, VAT and the taxation of the providers of CLP rewards, but they do little to address the tax considerations related to the receipt of these rewards in the hands of a customer. Therefore, this research contributes to the discourse on the taxation of the receipt of CLP rewards by a customer in terms of domestic South African tax legislation, and may go some way in furthering an international discourse in the field.

In conclusion, it is submitted that business operating models are in a constant state of change and if South African tax legislation does not update and reform accordingly, fiscal leakages will occur. These fiscal leakages have the power to erode and undermine the tax base and hinder the achievement of social and economic objectives. Similarly, these gaps may incentivise those wishing to reduce their tax burdens in a manner that does not contribute to the sustainability of the economy as a whole. Not addressing CLP rewards and the taxation thereof could perpetuate the economic disparities plaguing not only South Africa but many jurisdictions worldwide.