



**QUANTIFYING TAX REVENUE IN THE RETAIL SECTOR: A STORY OF CUSTOMER
LOYALTY PROGRAMMES IN SOUTH AFRICA**

by

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ABSTRACT

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Background: The South African government is in dire need of additional sources of tax revenues as they have consistently spent more than they have received in recent years. This need is further compounded by the damage caused by the COVID-19 pandemic. The focus on increasing tax revenues becomes increasingly more important when considering that tax legislation is required to adapt to changes in the business environment. In this context, customer loyalty programmes (CLPs) have increased in popularity in recent years, where the average South African customer makes use of 8.7 CLPs which are used by 74% of economically active South Africans. Consequently, not taxing the receipt of CLP rewards in the hands of these customers, in accordance with the gross income definition, results in the loss of much needed tax revenues by the South African *fiscus*.

Main purpose of the study: This study aims to quantify the potential tax revenues from the taxation of CLP rewards earned by customers of the Pick n Pay Smart Shopper programme (Smart Shopper).

Method: This study follows a qualitative research paradigm using a longitudinal instrumental case study. The case study applicable to this study is Smart Shopper. An analysis is presented of the applicability of the gross income definition under the Income Tax Act to the CLP rewards received by customers of Smart Shopper. Thereafter, an analysis of IFRS 15 is conducted to gain an understanding of the accounting disclosures that allow the researcher to quantify the CLP rewards of Smart Shopper. Thereafter, Smart Shopper is analysed on a longitudinal basis from a financial perspective in order to quantify the CLP rewards awarded to customers over a period of time, namely the financial years of 2018

until 2021 using the financial statements of Pick n Pay Stores Limited. The preferred mechanism for taxation is then applied to these rewards in order to quantify the tax revenue that the South African *fiscus* could have received by taxing CLP rewards since the introduction of relevant accounting disclosures.

Findings: The research revealed that between the 2018 and 2021 financial years, the South African *fiscus* could have received R95 million in tax revenue if the customers of Smart Shopper had been taxed at a WHT rate of 25% on the CLP rewards which they had earned.

Conclusions: The benefits of the proposed taxation of CLP rewards, in the form of a WHT include increased tax collection while maintaining taxation at a progressive rate, decreased non-compliance and an increased tax base from which tax revenues were not levied before. While this study concludes that the tax revenues from a single CLP in South Africa would be R94.6 million it is indicative that the levy of taxes on these CLP rewards may well be the first step in eliminating the South African budget deficit and increasing much needed tax revenues.

Keywords: Customer Loyalty Programmes, Rewards, Tax, IFRS 15, Tax Base, South Africa, Withholding tax, Revenue Reform.

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LIST OF ABBREVIATIONS AND ACRONYMS

Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
CIR	Commissioner for Inland Revenue
CLP	Customer Loyalty Programmes
CPA	Consumer Protection Act 68 of 2008
CSARS	Commissioner for the South African Revenue Service
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standards
Pick n Pay	Pick n Pay Stores Limited
SARS	South African Revenue Service
SIR	Secretary for Inland Revenue
Smart Shopper	Pick n Pay Smart Shopper Programme
The Act	Income Tax Act No. 58 of 1962
WHT	Withholding tax

CHAPTER 1: INTRODUCTION

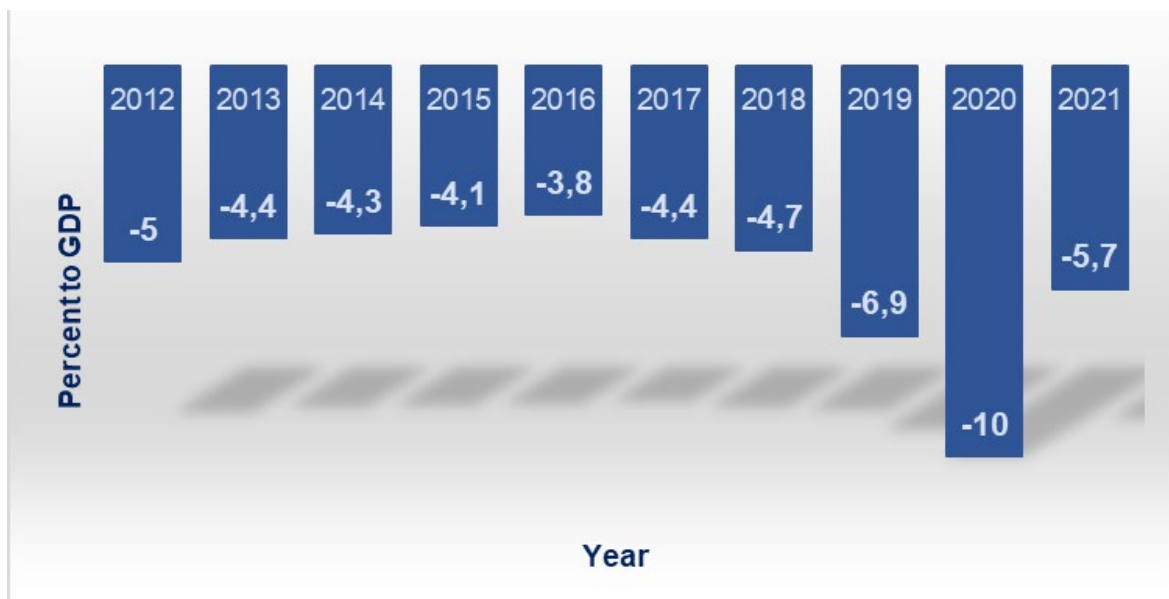
1.1. BACKGROUND FOR THE STUDY

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

The prevalence of CLPs is also indicative of a change in the nature of the economic transactions occurring between business and customers in South Africa. Interestingly, research indicates that there has been no change in how these transactions are taxed in order to correspond with the change in business (Odendaal & Pidduck, 2014:10; Pidduck & Odendaal, 2013:1521; Pidduck *et al.*, 2019:627; Swanepoel & Pidduck, 2020:76-77). In general, the South African tax system provides the tax revenue to fund the expenditure incurred by the South African government (National Treasury, 2021b:57). Therefore, the taxation of the CLP rewards in the hands of customers should increase tax revenues in South Africa. Increasing tax revenues is critical as the South African government is in dire need of additional sources of tax revenues, as they have consistently spent more than they have received in tax revenues in recent years (National Treasury, 2021a:10). Furthermore, it is acknowledged that the South African government is in need of additional tax revenue resulting from the damages caused by the COVID-19 pandemic, which has caused severe disruptions to economies all over the world (National Treasury, 2021a:13).

According to the South African Revenue Service (SARS), the actual net collections represented a contraction of 7.8% in the 2020/2021 fiscal year in comparison to the 2019/20 fiscal year, and the projected 2020/21 tax collection shortfall was expected to be the largest on record (National Treasury, 2021b:3,10). This upsurge in government spending is expected to increase globally in the short term and the focus on tax revenues is inherently becoming even more important (OECD, 2021:5). Consequently, the public finances of South Africa are dangerously overstretched, and the borrowing requirement of National Treasury is expected to remain above R500 billion per year in the medium term, leading the gross loan debt to increase from R3.95 trillion in the 2020/21 fiscal year to R5.2 trillion in 2023/24 (National Treasury, 2021b:9). The GDP growth in South Africa is projected to be 2.1 % for 2022 (National Treasury, 2022:5). Figure 1 below depicts the government deficit over time and indicates that it is a growing cause for concern for South Africa.

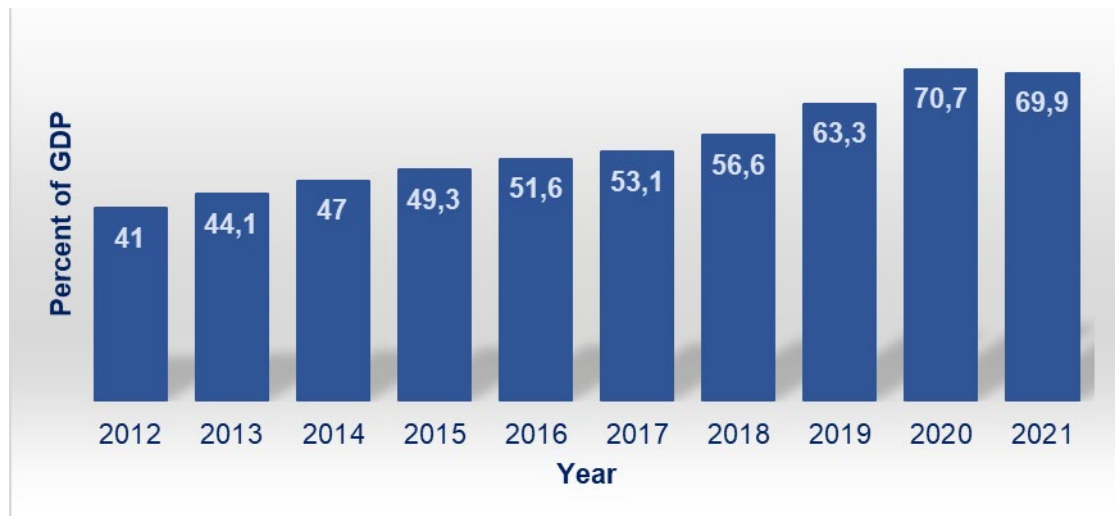
Figure 1: Government Budget Deficit



Source: Trading Economics (2022a)

Moreover, the need for additional tax revenue is emphasised by the steadily growing government Debt to Gross Domestic Product (GDP) ratio as illustrated in Figure 2.

Figure 2: South African Government Debt to GDP



Source: Trading Economics (2022b)

From a review of the growth in the national debt in Figure 2, a trend that is expected to continue in the medium term, the contractions in tax collections over the past years indicate that the *fiscus* is in need of additional revenue collections by expanding the tax base (National Treasury, 2021b:2). An increase in tax of up to R40 billion would be needed to help stabilise public debt and return public finances to a sustainable portion over the four years following 2020 in order to get the economy running smoothly again (National Treasury, 2021b:39). Furthermore, the South African government should be wary of the continued reliance on borrowing, as the 2021 Debt to GDP ratio is reflected as 69.9% while the European Union (EU) suggests a Debt to GDP ratio at a maximum of 60% for member countries (European Commission, 2022). To assist the *fiscus* in reducing the South African government deficit and Debt to GDP ratio, it has been identified that there is a portion of the existing tax base that is not taxed in the form of CLP rewards.

Notwithstanding the concerns related to South Africa's government deficit, there are no specific guidelines on the income tax treatment of CLPs, both in the hands of customers and in the businesses providing it (Brink, 2014; Swanepoel & Pidduck, 2020:98). In brief, South Africa's taxing legislation, the Income Tax Act No. 58 of 1962 (the Act), provides for a deduction of expenditure for one party to a transaction and an inclusion in income for the other (Odendaal & Pidduck, 2014:7; Pidduck & Odendaal, 2013:1524; Swanepoel & Pidduck, 2020:77). However, in the context of CLPs, two recent cases were considered by the judiciary in *Big G Restaurants (Pty) Limited v CSARS*, 2020 (6) SA 1 (CC) (82 SATC 403) and *Clicks Retailers (Pty) Limited v CSARS*, 2021 (4) SA 390 (CC). The two

aforementioned cases are kindred not only because they are two of the few tax cases to appear before the Constitutional Court of South Africa, but also because they are two of the first cases to address the taxation of CLPs. Interestingly, while the taxpayers in these cases failed in their attempts to claim a deduction under Section 24C of the Act (for future expenditure to be incurred in relation to their CLPs), they are still able to deduct expenditure incurred in respect of the CLPs under the general deduction formula envisaged in Section 11(a) of the Act (Brink, 2014; Pidduck & Odendaal, 2013:1526). Nevertheless, the corresponding rewards received by customers are not taxed and indicate a disparity in the taxation of CLPs, since providers are able to deduct expenditure incurred in respect of CLPs, whereas the rewards are not taxed in the hands of the recipient (Odendaal & Pidduck, 2014:7; Pidduck & Odendaal, 2013:1524; Pidduck *et al.*, 2019:627; Swanepoel & Pidduck, 2020:77).

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

In addition to quantifying the value of CLP rewards in attempting to quantify possible tax revenues, prior research also considered various mechanisms to tax CLP rewards (Odendaal & Pidduck, 2014; Pidduck & Odendaal, 2013; Pidduck *et al.*, 2019). One mechanism that was considered was the inclusion of the CLP rewards into the income of individuals similar to that of employment income, where the value of CLP rewards received by a customer would be recorded and pre-populated on the customer's individual tax return. This mechanism would allow the CLP reward income to be included in the calculation of the individual's taxable income to which the current progressive tax tables could be applied (Pidduck *et al.*, 2019:639). However, businesses would be required to provide customers

with the necessary documentation each year to allow for CLP income to be included in their income and would create an additional administrative burden for businesses (Pidduck *et al.*, 2019:639). In addition, this mechanism may also result in a higher tax liability for taxpayers upon the assessment of their tax returns due to the taxpayer being taxed at higher tax brackets than before and may be considered unfair by taxpayers (Pidduck *et al.*, 2019:639). Furthermore, customers are sensitive to increases in expenditure and a tax on CLP rewards in this manner may undermine the essence of a CLP, as customers may not opt to join the programmes (Pidduck & Odendaal, 2013:1528). Therefore, the aforementioned researchers rejected this mechanism.

Consequently, Pidduck and Odendaal (2014; 2013) proposed a flat rate of withholding tax (WHT) to be applied to CLP rewards. The WHT proposed reduced the risk of a perceived additional tax burden by customers as they would receive the CLP reward after the deduction of the WHT and therefore would not be liable to pay additional tax upon submission of their tax returns (Pidduck & Odendaal, 2013:1528). However, this mechanism did not consider the fundamental principles embraced in a progressive tax system in its attempt to broaden the tax base (Pidduck *et al.*, 2019:630). A fundamental principle of a progressive tax system is that a progressive tax rate results in greater tax revenue and decreases income inequality, where higher earning taxpayers would pay a higher rate of tax and a lower tax rate would be applied to lower earning taxpayers (Inchauste, Lustig, Purfield & Maboshe, 2015:35; Lebert, 2021:78).

Taxing CLP rewards through a mechanism that is fair and promotes equality in coherence to a progressive tax system will lead to increased revenue for the *fiscus*. Therefore, quantifying any tax revenues that could be collected on CLP rewards via a progressive WHT has become an important aspect to research due to the increase in the South African government's expenditure (Pidduck *et al.*, 2019:626). Moreover, the conflict in the nature of CLPs as well as their corresponding tax consequences should be of high importance to the government due to the South African tax policy aiming to avoid any tax loss (Pidduck & Odendaal, 2013:1522). Whether the amount of tax revenue forgone by not taxing CLP rewards will justify the changes required to tax the rewards, can only be further investigated upon determining what the potential tax revenues are.

1.2. RATIONALE FOR THE STUDY

This study forms part of a greater study which aims to determine what the potential tax revenue from the taxation of CLP rewards may be. In quantifying this tax revenue, it may be determined whether the administrative changes required to tax the CLP rewards are justified in light of the amount of tax revenues to be collected and may lead to further research into the feasibility of taxing CLP rewards with the goal of increasing revenue collections by the *fiscus*. For the purpose of this and the greater study, reliance will be placed on the disclosure presented in the annual financial statements of the various CLP providers selected for use in order to quantify the tax revenue on CLP rewards received by customers. The annual financial statements of these various CLP providers were compiled using the reporting framework of the International Financial Reporting Standards (IFRS) as per the Companies Act of 2008 and the Companies Regulation Act of 2011 (Companies & Intellectual Property Commission, 2022; International Accounting Standards Board, 2016).

Prior to 2018, the deferred revenue presented in the annual financial statements of the providers that offer CLPs were presented based on the IFRS standards, International Financial Reporting Interpretations Committee (IFRIC) 13 (IFRS Foundation, 2021). However, from the implementation date in January 2013 IFRIC 13 was heavily criticised as the deferred revenue (revenue linked to the CLP rewards) presented in the annual financial statements was entirely dependent on company specific judgement and interpretation of IFRIC 13 (Johansson & Ringius, 2007:12). Consequently, this led to inconsistencies in the amount presented by companies offering CLPs and also impacted any attempts to quantify the tax revenues forgone as a result of not taxing CLP rewards in the hands of customers.

Due to an increase in the use of CLPs, a need arose for the International Accounting Standard Board (IASB) to replace IFRIC 13 and its related standards to allow for a more uniform and consistent presentation of deferred revenue relating to CLPs (Muc, 2022:1). Therefore, from 1 January 2018, IFRIC 13 and its related standards were superseded by IFRS 15 (Deloitte Touche Tohmatsu Limited, 2016:2-3; International Accounting Standards Board, 2021:A885). IFRS 15 requires companies to implement a five-step approach to recognise, measure and present revenue and deferred revenue (now referred to as “contract liability”) received from a customer (Dili, 2017:1; International Accounting Standards Board, 2021:A890) (the International Accounting Standards Board is further referred to as IASB).

The application of the five-step approach in IFRS 15 derived from CLPs in the annual financial statements will allow researchers to quantify the tax revenues on CLP rewards with greater accuracy than before. Furthermore, contract liabilities disclosed by all of the companies analysed in this and the greater study should be accounted for and disclosed on the same consistent basis as required by IFRS 15 and should ensure a more reliable method of quantifying tax revenues on CLP rewards.

While prior research has been conducted to quantify the value of tax revenues on CLP rewards in South Africa, such as Pidduck *et al.* (2019) and Pidduck and Odendaal (2014; 2013), this field of research has not been saturated, as these (and other) studies and new circumstances revealed the further need for research. The first indicator is that these studies used values gleaned from accounting disclosure that was based on IFRIC 13 which was applicable at the time. The implementation of IFRS 15 presents an opportunity for further research using updated disclosures (IASB, 2021:A885). Moreover, the prior studies had scoping and sampling limitations in addition to the aforementioned limitations regarding the valuation related to accounting disclosures. Therefore, there is a necessity for further research to be conducted to quantify the taxation revenue on CLP rewards in the hands of customers, to determine whether the tax revenues would in fact contribute in a manner that would outweigh any onerous legislative or administrative amendments.

1.3. RESEARCH PROBLEM

Substantial growth has been experienced in CLPs in South Africa over the past decade and they are used by over 74% of those who are economically active (Cromhout, 2021:5). However, there has been no change in the taxation of CLP rewards in the hands of the customer (Pidduck & Odendaal, 2013:1521). Although research has been conducted to quantify the loss to the *fiscus* from CLP rewards in 2013, 2014 and 2019, this research was conducted using the now superseded IFRIC 13 (Odendaal & Pidduck, 2014; Pidduck & Odendaal, 2013; Pidduck *et al.*, 2019). IFRS 15 now provides mandated disclosure related to CLPs that would facilitate quantification of the tax revenues on CLP rewards. These disclosures may be utilised to determine whether the value of the tax revenues would outweigh any onerous legislative or administrative amendments and contribute towards the R40 billion that would be needed to help to stabilise public debt and stabilise public finances in South Africa. **Therefore, this and the greater study aim to quantify the potential tax revenues from the taxation of CLP rewards by customers.**

1.4. RESEARCH QUESTION

The key research questions applicable to this study are expressed as:

How much potential tax revenue could the South African *fiscus* have received by taxing CLP rewards since the introduction of relevant accounting disclosures?

1.5. RESEARCH OBJECTIVES

The objectives formulated to answer the research questions and achieve the goal of the greater and this study are as follows:

- 1. Define the characteristics of a CLP for the purposes of this study that would result in rewards which would potentially be subject to tax in the hands of the customers under the Gross Income definition in the Income Tax Act No. 58 of 1962.**
- 2. Analyse the terms and conditions of the most widely used loyalty programmes in South Africa to determine whether they meet the defining characteristics of a CLP for the purposes of the study.**
- 3. Analyse the annual financial statements of the providers of the selected CLPs in order to quantify the value of the CLP rewards issued to customers.**
- 4. Quantify the cumulative potential tax revenues forgone by the South African *fiscus* as a result of not taxing CLP rewards.**
5. Compare the taxation of CLPs to other jurisdictions using authoritative literature.
6. Analyse the terms and conditions of the most widely used CLPs in South Africa to determine whether they meet the defining characteristics of the charging section for the purposes of Value-Added Tax in South Africa.

This study focuses on quantifying the potential tax revenues from the taxation of CLP rewards earned by users of one particular CLP, namely the Pick n Pay Smart Shopper programme (“Smart Shopper”) (refer to Section 1.6.4 for the selection process of CLPs used in this and the greater study). The results of this study contribute to that of the greater study. This study is limited in scope to Objectives 1-4 as set out above. The greater study includes additional CLPs as part of Objectives 1-4 as well as Objectives 5 and 6 that were not addressed in this particular study.

1.6. RESEARCH DESIGN AND METHODOLOGY

Even though this study only relies on one case study, the greater study relies on multiple case studies and therefore the larger study follows a qualitative research paradigm through the use of multiple longitudinal instrumental case studies (Creswell & Creswell, 2018:13-14; Yin, 2018:51). Qualitative research is based on individuals constructing a meaning through an interaction with their world (Merriam & Grenier, 2019:3). Qualitative research methods are used to provide an in-depth understanding of the research problem and it is useful for exploring new topics or understanding complex issues (Hennink, Hutter & Bailey, 2020:29). Additionally, it also involves the collection of data and its analysis to allow the researcher to interpret the meaning behind the data (Creswell & Creswell, 2018:4).

Notwithstanding the above, qualitative research may be utilised to interpret quantitative information (Hennink *et al.*, 2020:29). A portion of the data used in this study is in the form of financial information from annual financial statements, specifically from the disclosure requirements of CLPs in terms of IFRS 15 to obtain the value of the CLP rewards issued in each financial year. Data used further includes non-financial data in the form of authoritative literature, legislation, case law, terms and conditions of various CLPs, as well as the IFRS 15 accounting standard.

Therefore, a qualitative research methodology is consistent with the purpose of this study as it aims to quantify the tax revenues from the taxation of CLP rewards. However, to quantify the tax revenues the complex IFRS 15 contract liability (the amount of CLP rewards awarded to customers by providers) disclosure as well as the terms and conditions of CLPs, relevant legislation and case law needs to be understood and analysed. In doing so, the research will provide an in-depth understanding of the significance of the taxation of CLP rewards for the *fiscus* based on the quantified tax revenues that have been forgone.

1.6.1. LONGITUDINAL INSTRUMENTAL CASE STUDY RESEARCH

A multiple longitudinal instrumental case study is a unique variant of qualitative research (Yin, 2018:51). Case study research is a qualitative approach and is described by Creswell and Creswell (2018:119) as an approach:

“in which the investigator explores a real-life, contemporary bounded system (a case) or multiple bounded systems (cases) over time, through detailed, in-depth data collection involving multiple sources of information (e.g., observations, interviews, audio-visual material,

and documents and reports), and reports a case description and case themes. The unit of analysis in the case study might be multiple cases (a multisite study) or a single case (a within-site study).”

Therefore, a case study approach may be a single-case case study or incorporate multiple cases which is the study and evaluation of more than one case (Saunders, Lewis & Thornhill, 2007:140). A multiple-case case study is appropriate to establish whether the findings in one case may be observed in other cases. As a consequence, a generalisation may be made from these findings (Saunders *et al.*, 2007:140). For the purposes of this study, the case study approach is applicable as financial statements and other non-financial data such as IFRS standards, legislation, case law as well as terms and conditions of various CLPs are analysed to obtain the value of rewards used so that it may be used as a basis to describe the tax revenues that the *fiscus* may be able to collect from CLP rewards. Moreover, for the purpose of the greater study, a multiple-case case study is applied because multiple CLPs will be selected to quantify the tax revenues for the greater study of which the selected CLP for this study forms part. Therefore, a multiple longitudinal instrumental case study is suitable for the purposes of achieving the research objectives of the greater study of which this study forms part.

In addition to the use of a multiple-case case study design, a longitudinal study design is used for the purposes of this and the greater study. Saunders *et al.* (2007:601) define a longitudinal study as “the study of a particular phenomenon (or phenomena) over an extended period of time”. A longitudinal study is one of the few ways in which a person is able to collect data over a long period of time (Saunders *et al.*, 2007:252). Additionally, the time intervals cover trends over elongated periods to address a development in a course of interest (Yin, 2018:51). Therefore, a longitudinal study is suitable for the purposes of this and the greater study as the quantification of the tax revenue from CLP rewards is performed over a period of time, from when IFRS 15 was implemented in 2018 until 2021, so as to address the research question and the research objectives.

The instrumental case study is carried out in 3 phases as follows:

- **Phase 1 – Literature review and case study research** (Chapters 1 and 2). The first phase includes a comprehensive analysis of existing literature relating to CLPs in South Africa. The literature analysed includes *inter alia* the terms and conditions of various CLPs with a specific focus on Smart Shopper. It further includes relevant

legislation, IFRS standards, as well as literature relating to the appropriate mechanism to tax. This analysis allows for an understanding to be obtained on how various CLPs operate and to determine whether they meet the definition of a CLP for the purposes of this study. Furthermore, the review includes a description and analysis of the case selected as part of this study. Thereafter, an analysis of the taxing legislation and proposed mechanisms of taxation of CLP rewards to customers is performed, as it may be applied to the selected case.

- **Phase 2 – Longitudinal case study research and data analysis** (Chapter 3). An analysis of IFRS 15 is conducted to gain an understanding of the accounting disclosures that allow the researcher to quantify the CLP rewards of the selected CLP in Phase 2. Thereafter the longitudinal case study approach is employed in the remainder of Chapter 3. The CLP selected in Chapter 1 is analysed on a longitudinal basis from a financial perspective, in order to quantify the CLP rewards awarded to customers over a period of time using the financial statements of the provider. The preferred mechanism for taxation as recommended in Phase 1 is applied to these rewards, in order to quantify the tax revenue that the South African *fiscus* could have received by taxing CLP rewards since the introduction of relevant accounting disclosures.
- **Phase 3 – Conclusion and Recommendations** (Chapter 4). The third and final phase uses the proposed basis of taxation of CLP rewards from Phase 1 alongside the findings from Phase 2 to conclude on the potential tax revenues forgone by the South African *fiscus* as a result of not taxing the CLP rewards earned by customers of Smart Shopper. The researcher thereby answers the research question and addresses the stated research objectives. Thereafter, recommendations are made regarding the taxation of CLP rewards in South Africa in order to obtain tax revenue from these rewards.

1.6.2. UTILISATION OF IFRS 15 DISCLOSURE

The researcher utilised disclosure mandated by IFRS 15 in order to obtain the values necessary to quantify the CLP rewards awarded and thereby quantify possible tax revenues in Phase 2 of this study. It is important to note that in some instances it is necessary for calculations to be used to quantify the CLP rewards based on limited disclosures made in the annual financial statements. Should these disclosures not be accurate or complete, it

may limit the accuracy of the quantified tax revenues for purposes of this and the greater study.

The study and the greater study require the following four items from the financial statements, as well as from the terms and conditions of individual CLPs available on the provider's websites to quantify the value of the tax revenues with any measure of accuracy:

- Revenue from sale of goods
- The expected percentage of CLP reward points that will be used by customers as determined by each company
- Ratio of Rand purchases to points earned
- Value of each point

1.6.3. VALIDITY, RELIABILITY AND OBJECTIVITY OF THE STUDY

Objectivity and integrity should be continuously maintained throughout the performance of a study (Mouton, 2001:240). It is accepted that, throughout the performance of the study, the effect of error through bias or subjectivity should be minimalised to enhance the validity of the study and the conclusion based on the research performed (Mouton, 2001:110). It is further accepted that the perspectives and experience of the researcher may influence the study and affect the reliability of the study (Patton, 2002:566). The following steps are taken throughout the performance of the study to enhance and maintain the validity, reliability, and objectivity of the larger study and this study:

- Subjectivity and bias due to interpretation and application of both legislation and financial data is a cause for concern. Therefore, a phased research methodology (which is described below) is implemented to mitigate subjectivity and bias in this study:
 - **Phase 1:** Literature is analysed comprehensively to obtain a thorough understanding of information available. The analysis is conducted using authoritative bodies of work such as peer reviewed journals, books, legislation, and seminal case law. Similarly, CLP terms and conditions used in the study were obtained directly as published on the providers' websites.
 - **Phase 2:** The understanding obtained by the researcher in Phase 1 is applied in the analysis of the annual financial statements of Pick n Pay to quantify the potential tax revenue. The use of unreliable financial data generated by CLP providers is a cause for concern. However, this risk was mitigated as the annual financial statements of Pick n Pay are compiled in compliance with IFRS. IFRS

is accepted as a reliable framework as it is set with the foremost objective to develop globally accepted financial reporting standards that are understandable, enforceable and of high quality (IFRS Foundation, 2020:4). A rigorous process is followed in the setting of standards which includes research of perceived shortcomings, proposal for publication, redeliberating and finalisation as well as post-implementation reviews (Deloitte Touche Tohmatsu Limited, 2020). This process is extensive and multiple experts are involved, which leads to the conclusion that IFRS is reliable. However, even though IFRS is reliable, the application thereof in individual companies' financial statements may not be reliable. Therefore, companies are audited to determine whether their application of IFRS is acceptable. The annual financial statements of Pick n Pay were audited by a reputable international auditing firm (Ernst & Young Inc.) and the audit reports, and any effects of the audit reports were duly considered in the performance of the research (Pick n Pay Stores Limited, 2018:6-9; Pick n Pay Stores Limited, 2019:6-9; Pick n Pay Stores Limited, 2020:6-11; Pick n Pay Stores Limited, 2021a:6-9).

- The selection of the sample of instrumental case studies for use in Phase 2 of this and the greater study is an area where subjectivity and bias may be a concern. In order to address this concern predefined objective criteria as listed in 1.6.4 were used to eliminate subjectivity and bias in the selection of instrumental case studies. Furthermore, case studies were selected from a population which are the most widely used CLPs and therefore will be the largest contributors of the potential tax to be gained by the *fiscus* for the purposes of quantifying the potential tax loss (Cromhout, 2021:15).
- The researchers collaborated on the research proposal and actively engaged one another in critical thinking and professional scepticism to limit personal bias or subjectivity from affecting the study during the application of their minds.

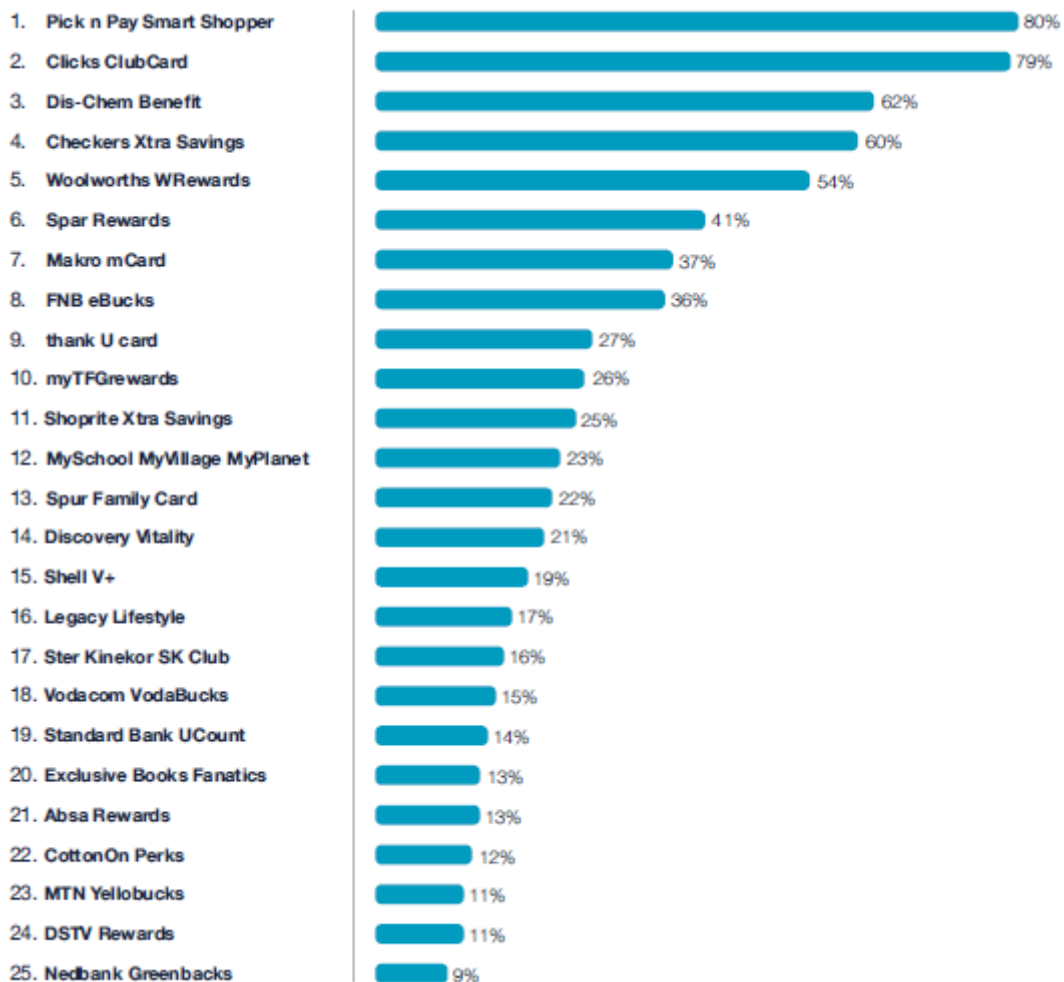
The following steps are taken throughout the performance of the study to enhance and maintain the validity, reliability, and objectivity of this study alone:

- An independent researcher reviewed the computations in Chapter 3 (Phase 2) to ensure the accuracy thereof, thereby improving validity and reliability of findings.

1.6.4. SELECTION OF CLPs

The method adopted for selecting the CLPs used in this and the greater study is known as purposeful maximal sampling, in which the researcher intentionally selects a CLP from a wide range of information-rich CLPs, based on the objectives of this study (Creswell, 2015:205; Patton, 2015). For the purpose of the greater study, the top 25 most used CLPs in South Africa as per the 2021 Truth & BrandMapp Loyalty Whitepaper were used as the population from which the sample was selected. Figure 3 illustrates the most used CLPs in South Africa.

Figure 3: Most used CLPs in South Africa



Source: Cromhout (2021)

All 25 of the most-used CLPs were initially considered for the purpose of the greater study, that is, to quantify the tax revenue from rewards granted to customers by CLPs. Following

this, the terms and conditions of the top 25 most used CLPs were inspected, analysed, and assessed against the following criteria:

- All CLPs that only provided an upfront discount or voucher to the customer (not a reward complying with the definition of gross income for tax purposes) were excluded from the selection in order to maintain the scope and focus of the study.
- All CLP providers that did not have financial data that was publicly available were excluded from the selection in order to enable the researcher to quantify the potential tax revenues and meet the research objectives.
- All CLPs that provided insufficient disclosure in terms of IFRS 15 were excluded in order to enable the researcher to quantify the potential tax revenues and meet the research objectives. Disclosure related to deferred revenue and/or contract liabilities and is clearly indicated as relating to the CLP was necessary for purposes of this study to quantify potential tax revenues.
- CLPs that had not been in operation for at least three years were excluded in order to enable the researcher to quantify the potential tax revenues and meet the research objectives, as this study is based on a longitudinal instrumental case study analysis.

The 20 CLPs that did not meet the above criteria are indicated in Table 2 below:

Table 2: CLPs not meeting criteria

CLP	CLP only provides an upfront discount/voucher	Insufficient financial data (not publicly available or insufficient disclosure)	CLP recently launched
<i>ABSA Rewards</i>		X	
<i>Checkers Xtra Savings</i>	X		X October 2019
<i>CottonOn Perks</i>		X	
<i>Discovery Vitality</i>		X	
<i>DStv Rewards</i>	X	X	X August 2020
<i>Exclusive Books Fanatics</i>		X	
<i>Legacy Lifestyle</i>		X	
<i>Makro mCard</i>		X	
<i>MTN YelloBucks</i>		X	X October 2020
<i>myTFGrewards</i>	X		

CLP	CLP only provides an upfront discount/voucher	Insufficient financial data (not publicly available or insufficient disclosure)	CLP recently launched
<i>MySchool MyVillage MyPlanet</i>		X	
<i>Nedbank Greenbacks</i>		X	
<i>Shell V+</i>		X	X February 2020
<i>Shoprite Xtra Savings</i>	X		X October 2020
<i>Spar Rewards</i>	X		
<i>Spur Family Card</i>		X	
<i>Standard Bank (UCount Rewards)</i>		X	
<i>Ster Kinekor SK Club</i>		X	
<i>thank U card</i>		X	
<i>Vodacom VodaBucks</i>		X	X July 2020
<i>Woolworths WRewards</i>	X		

Source: Own design

Checkers Xtra Savings, DStv Rewards, myTFGrewards, Shoprite Xtra Savings, Spar Rewards and Woolworths WRewards, which are contained in Column 2 of the table above, were all disqualified from this study, on the basis that these CLPs only provided an upfront discount and/or voucher to the customer when they purchase goods or services from the provider. Consequently, customers utilising the aforementioned CLPs do not get rewards (as defined for the purpose of this research) for purchasing goods or services.

Additionally, some of the population contained in Column 3 of the table above were excluded due to insufficient financial data being available, either due to a lack of disclosure relating to their respective CLPs in terms of IFRS 15, or due to the fact that they are private companies and are not obliged to publish their annual financial statements in the public domain. The respective CLPs of Makro and Shell are furthermore excluded, since the aforementioned companies are subsidiaries of multinational holding companies. Consequently, financial data relating to these CLPs is only presented for the aforementioned companies in their respective multinational holding company's financial statements, in which case insufficient segmented reporting is available for the researchers to utilise to meet the research objectives of the study.

Moreover, Column 4 of the table indicates that Checkers Xtra Savings, DStv Rewards, MTN Yellobucks, Shell V+, Shoprite Xtra Savings and Vodacom VodaBucks were all launched in 2019 and 2020 and thus insufficient data is available to facilitate a longitudinal study. Checkers Xtra Savings and Shell V+ were launched in October and December of 2019 respectively (BusinessTech, 2019; Shoprite Holdings Limited, 2020a). Vodacom, on the other hand, launched their VodaBucks CLP in July 2020 (Vodacom Group Limited, 2022). DStv Rewards came into effect in September 2020, whereas MTN YelloBucks and Shoprite Xtra Savings were both launched in October 2020 (BusinessTech, 2020; Ferreira, 2020; Shoprite Holdings Limited, 2020b). Therefore, the aforementioned CLPs have not been in operation for an acceptable duration of a minimum of three years for sufficient financial data to be available to which longitudinal case study analysis can be applied. Consequently, the remaining CLPs that met the selection criteria are:

- Pick n Pay Smart Shopper
- Clicks ClubCard
- Dis-Chem Benefit
- FNB eBucks

For the purposes of this study, research will be performed on Smart Shopper, while the other members of the research team will conduct studies on the remaining CLPs selected for use.

1.6.5. SCOPE AND LIMITATIONS OF THE STUDY

The greater study seeks to answer the research question posed of what the potential tax revenues to the South African *fiscus* is as a result of taxing CLP rewards. The key limitations on the scope of the study are explained below:

- This and the greater study are based on the South African market and are limited to CLPs that are operated in South Africa. They only address the tax implications of selected South African CLPs, therefore any conclusions made may not find application to other CLPs and countries.
 - The scope of this study for purposes of Phase 3 is further limited to Smart Shopper.
- This and the greater study are limited to the tax implications as they seek to quantify the potential tax revenues to the South African *fiscus* and do not attempt to generalise

global tax revenue. It may therefore be only of limited use for other jurisdictions and of greater value in other developing countries where similar circumstances exist.

- The greater study aims to set a starting point for the illumination of what the potential forgone tax revenues may be and does not seek to encompass and generalise all CLPs currently operated in South Africa; therefore, this study is limited in the scope as its findings relate to a limited number of CLPs.
- The greater study excludes certain types of programmes that have characteristics that do not conform to the definition of a CLP for purposes of this study, the inclusion of which may skew the findings of the study. Therefore, the findings of the greater study are limited to select CLP programmes.
 - This study further focuses on CLP reward points earned by using Smart Shopper and not on add-on benefits received that do not meet the definition of a CLP for the purposes of this study.
- This and the greater study do not aim to generalise the results to all CLPs in South Africa, as these programmes have widely differing terms and conditions and since a limited number of CLPs are used, it is unsuitable to generalise the results over all CLPs used in South Africa. However, the findings may provide insight into an appropriate application of legislation to CLPs in South Africa and these results may be applied to other CLPs with similar terms and conditions.
- The study does not claim to prescribe a final tax treatment for the taxing of CLP rewards, but rather to provide an indication of the potential tax revenues in order to determine the viability of taxing CLP rewards, so as to serve as a basis for further research on the topic.
- This and the greater study do not consider the behavioural changes of the affected customers and businesses that may occur as a result of the implementation of taxation on CLP rewards.
- This and the greater study are limited to the disclosures made in the annual financial statements of various CLPs. This study is specifically limited to disclosures made in the annual financial statements of Pick n Pay relating to its Smart Shopper programme. Due to the abovementioned limitations in disclosures, the researcher was obligated to make certain estimates and assumptions in order to calculate the value of rewards issued by Smart Shopper. These assumptions and estimates are discussed in Chapter 3 of this study.

- Although this study was conducted in 2022, the 2022 annual financial statements of Pick n Pay were not yet available and therefore are not included in the scope of this study.
- This study does not consider customers who use their cards for wholesale purchases of trading stock (Swanepoel & Pidduck, 2020:97).

1.7. STRUCTURE OF THE MINI-DISSERTATION

The structure of this study will be as follows:

Chapter 1: Introduction

Chapter 1 provides a background for the study by giving an overview of the topic, the rationale for the study and an outline for the research methodology to be followed. Furthermore, this chapter describes the research problem, research questions as well as the objectives relevant to the study.

Chapter 2: Literature review

Chapter 2 contains a critical review of relevant literature related to taxation of CLPs and CLP rewards earned by customers in South Africa. This chapter includes a discussion of how Smart Shopper operates, gross income as well as proposals for mechanisms of taxes.

Chapter 3: Data analysis and presentation of results

Chapter 3 contains an explanation of the accounting treatment followed by an analysis of the annual financial statements of the selected CLP and the calculation of tax revenues through the use of a WHT mechanism, based on the CLP rewards awarded longitudinally of the selected CLP (Smart Shopper).

Chapter 4: Conclusion

Chapter 4 concludes this study by summarising the findings. The chapter further highlights scope limitations and makes recommendations for future research.

CHAPTER 2: LITERATURE REVIEW

2.1. INTRODUCTION

Chapter 1 introduced the CLP landscape in South Africa, the research question, and objectives as well as the research methodology to be followed in the study. It was stated that the aim of this study is to quantify the potential tax revenues from the taxation of CLP rewards received by customers, as applied to Smart Shopper. In order to achieve this objective, a thorough understanding of the relevant literature is required. Chapter 2 presents a critical review of relevant literature related to taxation of CLPs in South Africa. The review includes an analysis of the operation of CLPs in general as well as the specific operation of Smart Shopper. In addition, an analysis of relevant legislation and the proposed mechanism to tax is performed herein.

2.2. UNDERSTANDING CLPs

In order to understand the accounting treatment and proposed tax on CLPs, it is beneficial to first understand the typical operation thereof, and thereafter, to explore various literature related thereto. CLPs are designed by companies to provide customers with benefits for remaining loyal to the company (Odendaal & Pidduck, 2014:6). However, there are various definitions of what a CLP is and what their various rewards entail and therefore, the concept of what a CLP is will be further explored by examining legislation specific to South Africa as well as various authoritative literature in order to reach a conclusion about which definition applies to this study.

The Consumer Protection Act No. 68 of 2008 (“CPA”) defines a **‘loyalty programme’** as
“... any arrangement or scheme in the ordinary course of business, in terms of which a supplier of goods or services ... offers or grants to a consumer any loyalty credit or award in connection with a transaction or an agreement”

The CPA also distinguishes between **‘trade coupons and similar promotions’** and **‘customer loyalty programmes’** whereby CLPs are considered a legal medium of exchange, whereas **‘trade coupons and similar promotions’** (discounts) are not seen as a medium of exchange.

Brink (2014:5) confirms that CLPs are available to the public and allow customers to accumulate benefits after making a purchase. Customers may thereafter decide to use these

accumulated benefits to either receive a good or service or to receive a discount on any future purchase of goods or services (Brink, 2014:5). Olivier and Burnstone (2014:3) categorise CLPs into two main types namely “Rewards Programmes” and “Customer Clubs”:

- **Rewards programmes** encourage specific consumer behaviour and reward customers in the process (Olivier & Burnstone, 2014:3). Customers are rewarded in the form of either a discount on a current transaction, an allocation of loyalty points that can be redeemed on a future transaction, or the reward may be used to purchase products and services from third parties (Olivier & Burnstone, 2014:3).
- **Customer clubs** offer a range of benefits to members, typically charge a membership fee, and do not reward members for specific transactional behaviours, but instead provide members with “retail discounts and/or value-added benefits” (Olivier & Burnstone, 2014:3).

The focus of this and the greater study is on CLPs that do not charge a membership fee and that do not offer immediate discounts. Hence, the aim is to research tax on CLPs where customers earn CLP rewards by using their loyalty card, and these rewards are later redeemed in cash or utilised against future purchases.

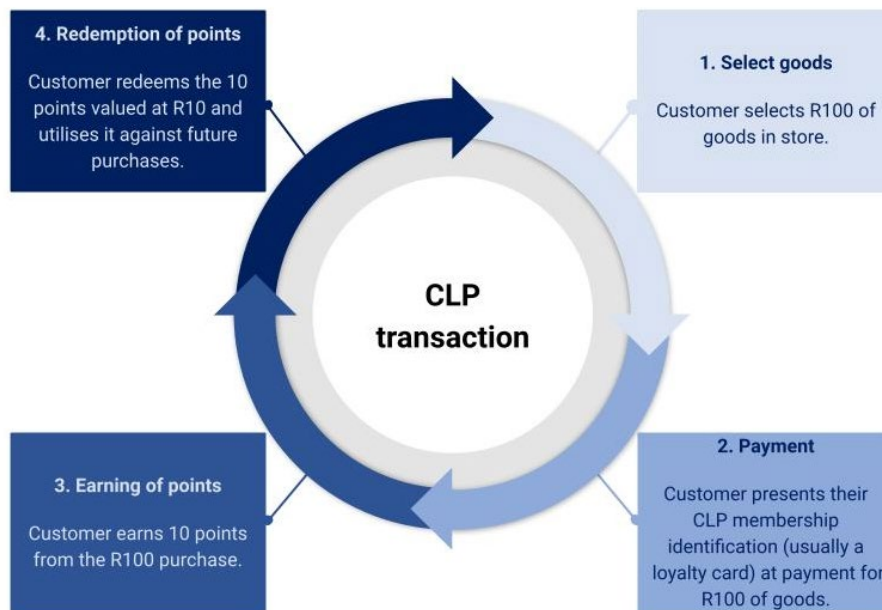
Chun, Iancu and Trichakis (2020) view CLP rewards as a “**new form of currency**”. Quantifying this “new form of currency”, namely the rewards received from CLPs, has become a prevalent issue and forms one basis of the difficulty which may be preventing National Treasury from introducing South African legislation to tax these rewards (Swanepoel & Pidduck, 2020:97). The loss of tax revenues that could be collected from a tax on these CLP rewards becomes more extensive in South Africa as their popularity does (Cromhout, 2021:5). Literature reveals that higher income households make greater use of CLPs than lower income households (Cromhout, 2021:12), which increases the loss of tax revenues in a progressive tax system. However, before taxation of CLPs may be considered, an understanding of the operation of CLPs is included below.

General CLPs in this study

The operation of CLPs to be addressed in the greater study have the following general workings. Ordinarily a customer selects goods to purchase, and upon payment they present their CLP membership identification (usually in the form of a loyalty card) and earn CLP reward points based on the value of the purchase. The customer may usually redeem these

CLP rewards in future or utilise them against future purchases. This process is illustrated in Figure 4 below.

Figure 4: Illustration of a typical CLP transaction



Source: Own design

This study focuses on the CLP rewards earned by customers of Smart Shopper which operates in a similar way to the general CLP illustrated in Figure 4. However, Smart Shopper contains distinct terms and conditions that are often features in some but not all CLPs in the South African market which prove relevant to this study. Therefore, it is crucial to understand the working of Smart Shopper which is discussed below.

2.3. UNDERSTANDING SMART SHOPPER

Smart Shopper was launched in 2011 and since its introduction it has become one of the most used CLPs in South Africa. From 2017 until 2020 it was the second most used CLP in South Africa (Cromhout & Netto, 2018; Cromhout & Netto, 2020). However, in 2021 Smart Shopper experienced significant growth resulting in 80% of South Africans using the programme (Cromhout, 2021). The Smart Shopper programme consists of two distinct components. The first is the earning of points and the second is upfront discounts and promotions. While the upfront discounts are not included in the scope of this study, the earning of points (CLP rewards) is within the scope of this study.

Pick n Pay customers make their purchases and identify themselves as a member of Smart Shopper by presenting their blue loyalty card or by using the PnP Mobile App to scan the QR (quick response) code at the payment terminal (Pick n Pay Stores Limited, 2022c). For each R2 spent in store by customers, they earn 1 point (Pick n Pay Stores Limited, 2022a). While the physical card remains the property of Pick n Pay, the points linked to the card are the property of the customer (Pick n Pay Stores Limited, 2022c). Furthermore, Smart Shopper customers are able to earn points at Smart Shopper partners which are TymeBank¹ and BP² (Pick n Pay Stores Limited, 2022c). Customers earn extra points when they use their TymeBank debit card to pay for goods (Pick n Pay Stores Limited, 2022c). Moreover, customers may earn points for any purchases of fuel from participating BP service stations (Pick n Pay Stores Limited, 2022c).

One hundred (100) points are equivalent to R1 and Pick n Pay retains the right to change the value of a point. However, since the launch of Smart Shopper the value of a point has remained consistent (Pick n Pay Stores Limited, 2022c). In order to redeem their points a customer must have a minimum of R5 or 500 points (Pick n Pay Stores Limited, 2022c).

There are multiple ways in which customers may redeem their points:

- Redemption by way of a reduction in their grocery bill (Pick n Pay Stores Limited, 2022a).
- Redemption at BP if they have a minimum balance of R20 on their card (Pick n Pay Stores Limited, 2022a).
- Purchase vouchers for Intercape bus tickets (Pick n Pay Stores Limited, 2022a).
- Customers may donate their points to a list of Smart Shopper charities (Pick n Pay Stores Limited, 2022b).

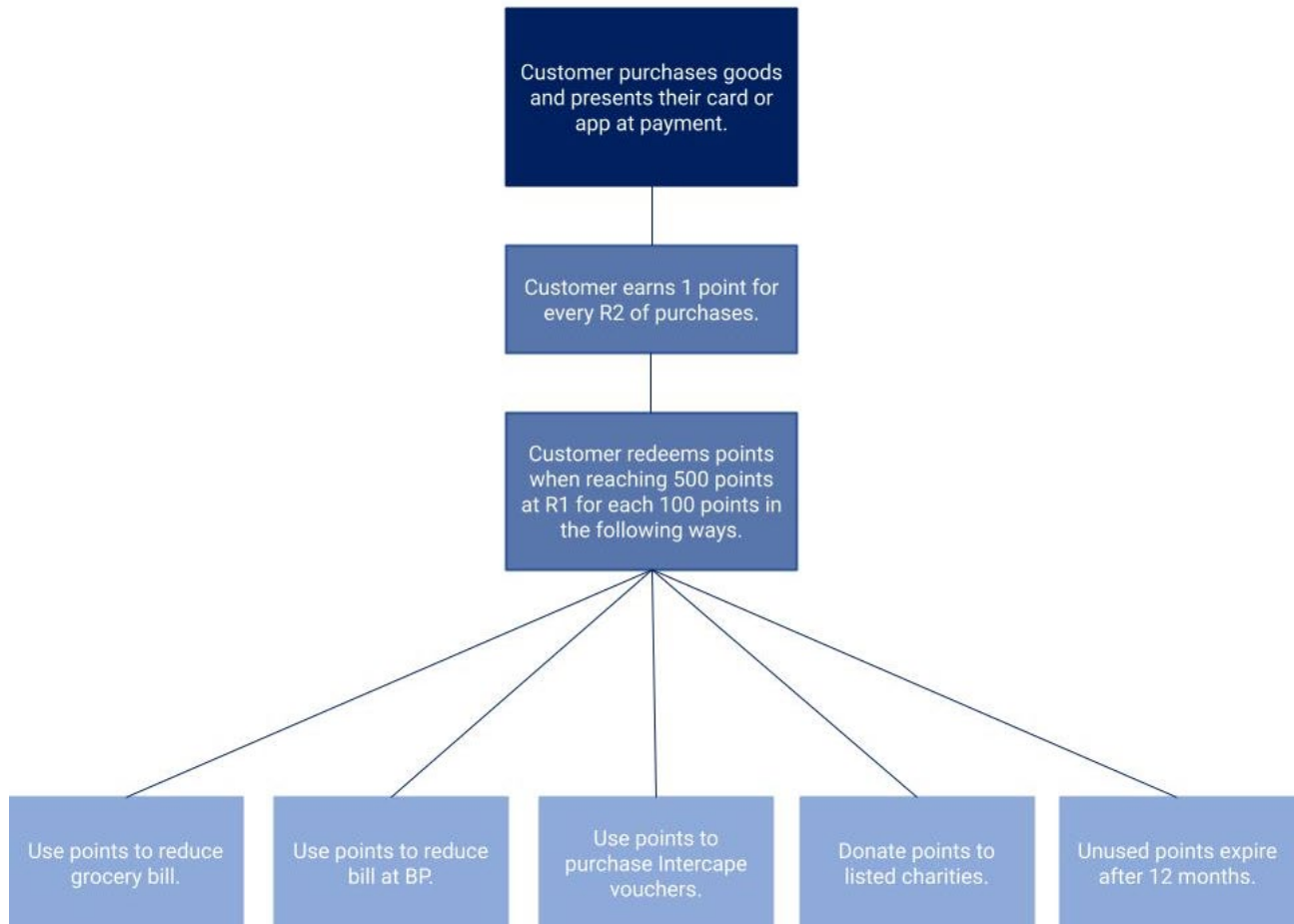
Customers may, however, not redeem their points in the form of physical cash. Smart Shopper points are valid for 12 months after which they expire and can no longer be redeemed. The financial statements of Pick n Pay do not disclose the amount or value of

¹ TymeBank is South Africa's first digital-only bank. They have kiosks in many Pick n Pay stores where customers may do their banking. BusinessTech. 2018. *TymeBank – everything you need to know about South Africa's first digital-only bank*. [Online] Available from: <https://businesstech.co.za/news/banking/283534/tymbank-everything-you-need-to-know-about-south-africas-first-digital-only-bank/> [Accessed: 2022-06-06].

² BP is a South African fuel provider and is one of Smart Shopper's partners where rewards may be earned and redeemed.

points that have expired in a given period. The above operation of Smart Shopper is depicted in Figure 5 below.

Figure 5: Illustration of Smart Shopper CLP transaction



Source: Own design

It is evident from the above that Smart Shopper meets the definition of a “rewards programme” as provided by Olivier and Burnstone (2014:3), as it rewards customers for purchasing at Pick n Pay with the allocation of loyalty points and this is included within the scope of this study. While Smart Shopper has terms and conditions similar to other CLPs, each CLP is unique. Table 3 below indicates some features of the CLPs that allow for a comparison with that of the Smart Shopper.

Table 3: Characteristic comparison of different CLPs

Characteristic	Pick n Pay Smart Shopper	Clicks ClubCard	Dis-Chem Benefit	FNB eBucks	Nedbank Greenbacks
Points earned for spending	R2 spending for 1 point	R5 spending for 1 point	1.5% of purchases is a point	Varies based on the customer's bank account type as well as their level	Varies based on package customer is on
Rand value of a point	100 points is R1	10 points is R1	1 point is R1	10 points is R1	Varies based on card type and earning rate
Earning points at 3 rd parties	Yes	Yes	Yes	Yes	Yes
Point balance needed to redeem	Yes, 500 points	Yes, 100 points	No	No	No
Conversion into cash	No	No	No	Yes	Yes
Redemption at 3 rd parties	Yes	No	No	Yes	Yes
Donation of points	Yes	No	Yes	Yes	Yes
Expiry of rewards	Yes, after 12 months	Yes, after 12 months	Yes, after 12 months	No	Yes, if the customer is disqualified from the programme

Source: Own design (Absa Bank Limited, 2022; Clicks Retailers (Pty) Limited, Not dated; Dis-Chem Pharmacies Limited, Not dated; FirstRand Bank Limited, 2021; Nedbank Limited, 2021)

Table 3 clearly indicates that while there may be similar features across CLPs, they are not homogenous due to various differences between CLPs (such as differences in points earning ratios, Rand value of points etc.). Therefore, determining the applicability of the gross income definition to specific CLPs is necessary.

2.4. UNDERSTANDING GROSS INCOME

After understanding the workings of typical CLPs as well as the Smart Shopper, attention is now shifted to understanding how the South African tax legislation applies to the rewards earned from these CLPs by customers. The departure point to determine whether an amount is taxable in South Africa is the gross income definition contained in the Act. Section 1 of the Act defines 'gross income' in relation to any year or period of assessment as:

“(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; ... during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder”

The amounts 'hereunder' in the definition refers to the list of 'special inclusions' following the definition of gross income. Special inclusions are specific items that override the aspects of the gross income definition. There is, however, no special inclusion for CLP rewards and thus the gross income definition needs to be applied for purposes of this study.

Research by Swanepoel and Pidduck (2020) performed an analysis to determine whether the receipt of CLP rewards by customers meet the gross income definition. In their analysis they emphasised multiple uncertainties arising due to the complexities of CLPs (including different terms and conditions of selected CLPs). Hereunder a similar analysis follows where the gross income definition is analysed and applied to the Smart Shopper programme. In the discussion below the uncertainties raised by Swanepoel and Pidduck (2020) will be addressed as they relate to Smart Shopper for each component of the gross income definition.

2.4.1. TOTAL AMOUNT IN CASH OR OTHERWISE

The words 'total amount in cash or otherwise' is not defined in the Act and therefore reference is made to seminal case law for guidance on application. The judgment in *Lategan v CIR*, 1926 SA 203 (CPD) (2 SATC 16) reveals that a right to payment in future that may be monetised constitutes an 'amount'. Furthermore, *CIR v Butcher Brothers (Pty) Limited*, 1945 SA 301 (AD) (13 SATC 21) brought forth the principle that an item may only be included in gross income if the 'amount' has an "ascertainable monetary value". Thus, despite the

requirement by Pick n Pay that a customer must have a 500-point balance to redeem their points, the customer may still have an 'amount' as in this context, it is evident that Smart Shopper rewards are redeemable by manner of exchanging them for goods and services, from which a monetary value may be derived.

Therefore, in order to determine the monetary value, one needs to consider the redemption of Smart Shopper points which is either utilisation against purchases or donation to selected charities (refer to Section 2.3 above). There is no option for customers to redeem points for physical cash. This, however, does not mean that the Smart Shopper does not meet the 'amount' requirement. In the case of *CIR v Delfos*, 1933 SA 242 (AD) (6 SATC 92) Page 99 it was held that "if it is something which is not money's worth or cannot be turned into money, it is not to be regarded as income". Therefore, CLP rewards do not need to be turned into cash in order to meet the 'amount' requirement of gross income (since this requirement may be otherwise than in cash), which in the case of Smart Shopper would be the goods purchased or donation to charities.

An alternative view identified by Swanepoel and Pidduck (2020:89) is that points earned may be seen as the CLP reward and not the goods or services that are received in the exchange. This view is supported by the judgment in the case of *Lace Proprietary Mines Ltd v CIR*, 1938 SA 267 (AD) (9 SATC 349) at 281 where the appellant sold mineral rights. In this instance the contract indicated that the consideration was £250 000, however, this amount was to be settled by the allotment of 1 million paid up shares with a value of 5 shillings each. The court held that the 'amount' in the case was the value of the shares and not the £250 000 as the appellant was not entitled to the cash consideration. Therefore, in the context of Smart Shopper, an 'amount' may be determined for gross income purposes on a similar basis as the monetary value of points is determinable. Therefore, even when the virtual CLP points are regarded as the CLP reward, as both CLPs (in particular the Smart Shopper) readily disclose their point-to-rand conversion ratio, the monetary value of such points is easily determined.

The ability to tax non-cash items was confirmed in the case of *CSARS v Brummeria Renaissance (Pty) Ltd & others*, 2007 SA 1338 (SCA) (69 SATC 205) where the taxing of notional interest income was allowed since the benefit of interest-free money may be ascertained. This creates an argument backed by case law for CLPs to be taxed, even at a

stage where there are only notional rewards that have not been redeemed yet (Swanepoel & Pidduck, 2020:89).

Therefore, CLPs whose rewards are not cash and cannot be converted into cash, such as those in the Smart Shopper, satisfy the 'amount' element of gross income, as the rewards have an ascertainable monetary value (a rand conversion rate). In the case of customers that obtain solely a cash benefit, the 'total amount' is the cash value of the rewards that the customer obtains. In the case of Smart Shopper, the rewards are 'otherwise' than in cash, as points are earned and utilised against purchases or donations. The value of these points may be ascertained as points are converted at a ratio of R1 for every 100 points earned which would represent the value of rewards earned (Pick n Pay Stores Limited, 2022c). Thus, the total amount or monetary value of Smart Shopper points earned is ascertainable. Attention is shifted to the next requirement in the gross income definition namely 'received by or accrued to'.

2.4.2. RECEIVED BY OR ACCRUED TO

In the case of *SIR v Silverglen Investments (Pty) Ltd*, 1969 (1) SA 365 (A) (30 SATC 199) precedent was created that an amount is included in gross income at the earlier of receipt or accrual. The basic understanding of the terms 'received by' and 'accrued to' are included below:

- In *Geldenhuis v CIR*, 1947 (3) SA 256 (C) (14 SATC 419) at 430, it was established that the term 'received by' must mean "received by the taxpayer on his own behalf for his own benefit". Therefore, a taxpayer would need ownership of the amount because receipt without ownership leads to an illogical and unreasonable interpretation of the law (*Geldenhuis v CIR*). '.
- 'Accrued to' means that the taxpayer is 'entitled to' the amount as held in *Lategan v CIR*. However, entitlement does not address the consequences of suspensive and resolutive conditions on amounts to be received by the taxpayer. Therefore, in *Mooi v SIR*, 1972 (1) SA 674 (A) (34 SATC 1), it was established that for something to accrue, that person must be 'unconditionally entitled' to it.

The most apparent time of 'receipt' is when CLP points are redeemed and exchanged for goods or services, as this is the time when customers obtain the CLP rewards for their own behalf and own benefit. Notwithstanding this, receipt may take place at an earlier time

depending on where ownership lies (Swanepoel & Pidduck, 2020:91). In addition to this, the accrual of CLP rewards should also not be ignored, in order to determine when accrual takes place (as this may be before actual receipt for tax purposes). Therefore, these issues are discussed below.

Ownership of points

As pointed out by Swanepoel and Pidduck (2020:91) the phenomenon of receipt depends on whether ownership of the CLP card is separated from ownership of the points. The terms and conditions of Smart Shopper states that membership cards remain the property of Pick n Pay. Despite this fact, customers may earn points by presenting their card, using their app, or providing their membership card number upon payment for goods purchased (Pick n Pay Stores Limited, 2022c). It is stated in the terms and conditions that it is solely the customer's responsibility to keep their card and points safe (Pick n Pay Stores Limited, 2022c). Nonetheless, since points may be earned by simply using the app, it may be argued that ownership of the physical card is separate from the ownership of points earned (Swanepoel & Pidduck, 2020:91). Therefore, as the customer is responsible for the points, which is not solely linked to the presenting of a card, the customer may be considered the owner of the points and not Pick n Pay. Consequently, the accrual and receipt of points to the customer takes place before the time of redemption for goods and services. However, the timing of when these points accrue to the customer as well as when the customer takes receipt of points is the complication under examination. Therefore, attention is now shifted to when points are accrued to customers.

Provider's obligation to allocate points

Clicks Retailers (Pty) Limited v CSARS, 2021 (4) SA 390 (CC) is a recent case that arose dealing with CLPs. Although the case does not address the gross income of the customer, it does shed light on the treatment of CLP rewards in the hands of the provider. In this context it is important to consider that a characteristic of CLPs is that rewards are earned by customers, but only utilised at a later stage resulting in a delay between when points are earned and when they are redeemed. However, when a membership card is issued to the customer, they become the bearer of the card and have the right to utilise the card although the provider remains the owner of the card (Swanepoel & Pidduck, 2020:92). In the case of *CSARS v Clicks Retailers (Pty) Limited*, 2020 (2) SA 72 (SCA) (82 SATC 167) at Page 171 it was stated that "If the customer has concluded a ClubCard contract and presents the card

at the point of sale, Clicks incurs an obligation under the ClubCard contract to award them points” which was confirmed in *Clicks Retailers (Pty) Limited v CSARS*, 2021 (4) SA 390 (CC).

Therefore, when a loyalty card is presented at the point of sale, the provider has an obligation to allocate the points earned to the customer. This obligation of the provider indicates that the customer is entitled to the points at the time of the sale of goods. Therefore, when the reward points are loaded onto the membership card held by the customer, the customer has a right to the points and this is an indication of entitlement to use the CLP rewards, despite ownership of the physical card being held by the operator (Swanepoel & Pidduck, 2020:92).

Therefore, accrual of points takes place upon the earning of points at the time of purchase of goods. However, even though the timing of accrual is now established, various complexities arise that may affect accrual, such as redemption of points, donation of points, as well as loss, theft and expiry of points, and these are discussed below.

Redemption of points

The first complexity is that customers of Smart Shopper are only allowed to redeem their points at the time that they have a balance of 500 points or R5 (Pick n Pay Stores Limited, 2022c). Bearing in mind that accrual may only take place at the time when a customer is ‘unconditionally entitled to’ (*Mooi v SIR*) their CLP rewards, which must be considered for purposes of accrual. In the case of Smart Shopper, customers are only unconditionally entitled to their points once they reach the minimum balance and thus it is concluded that CLP rewards only accrue to the customer once this point balance is reached. However, in the case of *CIR v People’s Stores (Walvis Bay) (Pty) Ltd*, 1990 (2) SA 353 (A) (52 SATC 9) it was held that an amount need not be due and payable for it to accrue. Therefore, in accordance with *CIR v People’s Stores*, even though the CLP points may not yet be exercised due to a minimum point balance being required, the CLP points accrue to the customer upon the provider’s obligation (*Clicks Retailers (Pty) Limited v CSARS*, 2021 (4) SA 390 (CC)) to allocate these points. Thus, there is a conflict in interpretation between these court cases in their application to CLP rewards which results in ambiguity regarding the timing of accrual of rewards in the hands of the customer.

Donation of points

A further complexity arises due to the transferability of points via donation. Smart Shopper allows customers to donate their CLP points to a list of charities consisting of: SPCA (Society for the Prevention of Cruelty to Animals), Pick n Pay School Club, Age in Action, 1000 Women Trust, Feed the Nation, CHOC (Childhood Cancer Foundation South Africa) and Agri SA (Agri South Africa) (Pick n Pay Stores Limited, 2022b). Precedent for donations is evident in the case of *CIR v Witwatersrand Association of Racing Clubs*, 1960 (3) SA 291 (AD) (23 SATC 380) where it was held that a person has beneficially received an amount even if they have an obligation to pay such amount to another person. Therefore, only if a person ceded the income before 'receiving or accruing it', would it not constitute gross income. Consequently, although CLP points may be donated, they first accrue to the customer, as the customer is not able to cede CLP points before earning the points (Swanepoel & Pidduck, 2020:92). As Smart Shopper customers have the sole discretion to donate to the listed charities, they cannot do so if the CLP points have not accrued to them, thus accrual does take place in the case of Smart Shopper before donations may take place and indicates once again that accrual of the CLP rewards occurs upon earning of the points and not redemption of the points.

Loss, theft and expiry of points

The effect of points expiring as well as loss and theft of points and cards must also be considered, as it is another complexity that may arise. In the case of Smart Shopper, points expire 12 months after being earned by a customer (Pick n Pay Stores Limited, 2022c). Therefore, expiry only occurs after points have been earned by the customer. Points accrue to the customer when these points are allocated to the customer. Furthermore, points are received by the customer when the points are allocated to the customer and have reached the 500-point balance. Therefore, it is clear that since accrual and receipt have occurred, these points must meet this requirement. The mere expiry of points does not indicate that a customer did not receive their points and therefore, expiry does not affect the meeting of the 'received by or accrued to' requirement.

Furthermore, if a customer of Smart Shopper's card is stolen, the thief is able to use the customer's points linked to the card. However, the same conclusion may be reached as with expiry of points, as the customer has already taken receipt of points when it is allocated to their card and thus the 'received by or accrued to' requirement is still met.

Conclusion on received by or accrued to

Based on the arguments above, it is concluded that CLP points do accrue to the customer as soon as they become available for use by the customer for their own behalf and own benefit. In most instances this occurs before redemption, where the customer exchanges the CLP points for goods or services (receipt of goods and services). In the case of Smart Shopper, the time of accrual may be considered unclear due to the minimum point balance of 500 points required before a customer may redeem the points. Nevertheless, Smart Shopper customers take receipt of their CLP points as soon as redemption occurs in the various manners as illustrated in Figure 5. Therefore, although the exact timing of accrual is unclear, it is clear that accrual does occur before the CLP rewards are beneficially received and thus the Smart Shopper programme satisfies this requirement of the gross income definition.

Thus, since the various CLPs present in South Africa have a multitude of terms and conditions impacting the timing of receipt and accrual of rewards, there remains complexity in determining when the 'received by or accrued to' requirement is met. In order to address this complexity, legislative reform is suggested, however, it would be impractical to address each individual CLP in legislation. Therefore, the suggestion of the researcher is that legislation must clarify the timing of receipt or accrual in a uniform manner to address all CLPs and to ensure a single point of taxation amongst the various CLPs present in South Africa (Swanepoel & Pidduck, 2020:92-93).

Nevertheless, the requirement of receipt or accrual is met by the customers of Smart Shopper and therefore the next requirement of the gross income definition namely 'not of a capital nature' is now discussed.

2.4.3. NOT OF A CAPITAL NATURE

The final element of the gross income definition is whether the amount is of a capital or revenue nature. If an item is of a capital nature, it will not be included into a taxpayer's gross income and consequently will not be taxed. As the Act does not define capital in nature, a multitude of cases have come into existence. The following principles from case law are particularly relevant when considering application to CLP rewards:

- In the case of *CIR v Pick n Pay Employee Share Purchase Trust*, 1992 (4) SA 39 (A) (54 SATC 271) a trust was set up to administer the company's share scheme. The

trust had to purchase shares from employees who forfeited them, and the resulting profit or loss was fortuitous. It was held that there was no “scheme of profit-making” in the share trade and therefore the amounts were capital in nature.

- In the case of *CIR v Visser*, 1937 SA 77 (TPD) (8 SATC 271) the tree and fruit principle was brought forth, where the income (fruit) is described to be born of capital (tree).

Therefore, it is necessary to study the difference between a casual CLP user and a CLP user who purposefully shops at partner retailers in order to earn CLP rewards, actively aiming to obtain a profit or personal gain (Swanepoel & Pidduck, 2020:96). The intention of the customer relating to how they earn their CLP rewards is a determining factor in determining the nature (capital or revenue) of the CLP rewards. However, since the intentions of different customers vary, it is impractical to determine each individual customer’s intention. Nonetheless, tax consequences must still be classified as either capital or revenue in nature (*Pyott Ltd v CIR*, 1945 SA 128 (A) (13 SATC 121)).

It may be said that a customer is engaging in a ‘profit making scheme’ when they switch from a mere use of CLPs to actively planning the use thereof (revenue in nature and to be included in gross income) (Swanepoel & Pidduck, 2020:96). Other customers may participate in CLPs and merely fortuitously or occasionally, receive CLP rewards on their purchases (capital in nature and not to be included in gross income). Therefore, such a customer may not be seen as carrying on a ‘scheme of profit making’ and his or her rewards would arguably be held as capital in nature. Consequently, there is no absolute decision as to whether the CLPs are revenue or capital in nature in the hands of customers, as it depends on each customer and calls for subjective analysis.

“The problem really calls for a legislative reform or an administrative (rather than a judicial) solution” (*Cohen*, (2009) 126(3) SALJ 489 at 504). Although this comment was made in the context of the *Brummeria* case, it may also be applied to CLP rewards. Should SARS aim to tax CLP rewards, the possibility of complexities arising as seen in the above analysis is likely. Therefore, it is likely that the best manner to address these complexities is by legislative amendment in the form of a special inclusion to the gross income definition rather than judicial consideration on an individual basis. This proposed amendment is similar to other special inclusions where an override of the capital or revenue requirement occurs. A legislative amendment in the form of a special inclusion would consequently prevent the

analysis of the capital or revenue intent of the 8.5 million Smart Shopper customers, which would be overly time consuming and impractical. Furthermore, as discussed in Section 2.4.2, clarification of the timing of receipt or accrual is also necessary in order to enforce homogenous application of the legislation amongst various CLPs in South Africa from a timing perspective. The override of timing is also not an unknown legislative amendment, as Sections 7B and 24M of the Act also provide timing overrides. Therefore, legislative amendment addressing the override of the capital or revenue nature, as well as the specification of timing of receipt or accrual is the best solution to ease the process of taxation of CLP rewards (Swanepoel & Pidduck, 2020:97).

2.4.4. CONCLUSION ON GROSS INCOME

In the process of the above analysis, it was determined that there is a quantifiable amount being accrued to and later received by CLP customers in the form of reward points in respect of Smart Shopper. However, there is uncertainty regarding at what time these points accrue to the customer, as well as whether or not these CLP rewards are of a capital or revenue nature. Therefore, for the purpose of this study, the researcher will apply the recommendations made by Swanepoel and Pidduck (2020:96), that CLP rewards earned by customers of CLPs (including Smart Shopper) are subject to a special inclusion into gross income that overrides the capital or revenue inquiry and specifies that accrual takes place at the time when the CLP rewards are earned.

2.5. COMPARATIVE INTERNATIONAL TAXATION

While the focus of this study is to quantify the potential tax revenue the South African *fiscus* could have received by taxing CLP rewards issued to customers of Smart Shopper, brief insight into global trends into the taxation of CLP rewards is included herein to provide a greater context. Swanepoel and Pidduck (2020:85-88) identified that there are a small number of authorities worldwide that have issued guidance on taxation of CLPs. The Canadian Revenue Authority indicates that employees may collect points on business trips but are not taxed on such amounts and there is no mention of loyalty points earned outside of employment (Canada Revenue Agency, 2022). In the United States of America, a similar view is taken, as loyalty points earned in the course of employment are not taxed (Internal Revenue Service: United States of America, 2002:1). The Internal Revenue Service in America has proposed tax rules for providers of CLPs; however, it is not clear whether a

similar proposal will be made for tax on customers (Suttora & Shi, 2020). Furthermore, in Australia CLP rewards from private expenditure are not taxed, however rewards are taxed in some cases when they relate to employment (Australian Taxation Office: Australian Government, 2004). In New Zealand no income arises for the customer, as further Goods and Services Tax has guidance for the provider, but there is no guidance on taxation in the hands of the customer (Inland Revenue: New Zealand Government, 2004; Inland Revenue: New Zealand Government, 2009; Inland Revenue: New Zealand Government, 2016).

Therefore, as identified by Swanepoel and Pidduck (2020:87), there is limited guidance on taxation of CLPs internationally and the majority of the guidance relates to that of the provider. The various taxes implemented mostly relate to fringe benefits or indirect taxes instead of normal tax consequences. It is clear that comparatives in other jurisdictions are not available for retail-based CLPs in South Africa, and this indicates the need for research in South Africa and worldwide (Swanepoel & Pidduck, 2020:88).

2.6. PROPOSAL OF WITHHOLDING TAX

Following the conclusion that CLP rewards earned by customers of Smart Shopper should be included in a customer's gross income, and the lack of guidance on a global front, a mechanism to collect this tax on CLP rewards is required. In this context it is important to consider that the average South African subscribes to 8.7 loyalty programmes (Cromhout, 2021:8). During the 2021 financial year, the Smart Shopper programme had 8.5 million active customers (Pick n Pay Stores Limited, 2021b:54). In light of these statistics, it is evident that a tax on CLP rewards would impact millions of taxpayers in South Africa and cognisance of the ability of SARS to administer and collect such a tax is imperative.

The first method to collect such taxes that comes to mind would be to require each individual customer to disclose these amounts as gross income in their tax return. However this would be problematic as it leaves much room for error and manipulation. Therefore, simply requiring self-assessments on CLP rewards would impose a considerable administrative burden on SARS, as they may need to confirm the accuracy of these amounts. Such a suggestion is impracticable as SARS has limited administrative capacity due to the fact that around 200 SARS employees have lost their jobs during the process of restructuring (Nugent, 2018:91). A significant number of these employees were in management positions and were rejected when applying for alternative management positions (Nugent, 2018:91).

Moreover, SARS is currently looking to fill multiple positions which includes various specialists further indicating their current limited capacity (BusinessTech, 2022). In addition, customers who do not have to submit a SARS return due to earning less income than the rebate³ they are entitled to, would not include these rewards.

Therefore, an alternative solution to tax these rewards obtained by customers is crucial as the model established to collect taxes from CLP customers should not place an onerous administrative burden on SARS or rely on manipulatable input from customers. The systems should be efficient enough that the benefit of collecting taxes from CLP customers outweigh the cost incurred. Prior research on CLP rewards also identified these problems and concluded that a WHT mechanism may be best suited as it reduces the administrative burden on both SARS and the taxpayer (Odendaal & Pidduck, 2014:13; Pidduck & Odendaal, 2013:1527; Pidduck *et al.*, 2019:639).

A WHT is merely a mechanism to collect tax, it is not a tax in itself and it does not relieve the taxpayer from their responsibility to register for South African tax purposes (Olivier & Honiball, 2011:359). South Africa currently utilises WHT to collect taxes *inter alia* on immovable property, dividends, interest and royalties, thus, it is a valid mechanism available for the collection of taxes (National Treasury, 2022:188). The reasoning behind prior researchers' proposals for a WHT system is that a WHT allows for large amounts of tax revenue to be collected quickly since the tax is directly collected when income is paid in the current year (Saptono & Aditama, 2022:109). Furthermore, the use of a WHT decreases the administrative burden for SARS through the utilisation of existing structures of WHT as well as ease for taxpayers upon submission of tax returns through the use of electronic and pre-populated systems (Pidduck *et al.*, 2019:641).

Moreover, the use of a WHT facilitates greater compliance by taxpayers where research has revealed that compliance when subject to a WHT is near to perfect at a rate of 99% (Thomas, 2019:90). In contrast, compliance with income tax that is not subject to a WHT or any third-party information is less than 40% (Thomas, 2019:90). Additionally, the use of a WHT allows all customers who receive CLP rewards to be subject to tax, as opposed to only those who are registered for tax in South Africa (Pidduck & Odendaal, 2013:1528). Therefore, the *fiscus*

³ A rebate is a reduction against tax payable to SARS. The rebate referred to here is reduction of actual taxes due to SARS based on the taxpayer's age. If a person's tax due to SARS is below the rebate amount, they are not required to submit a tax return.

would be able to collect tax, even if taxpayers fail to file returns and this would enable additional taxpayers to be brought into the tax system (Thomas, 2019:91).

Nevertheless, a drawback of WHT is that it is usually levied at a flat rate which places a larger tax burden on low-income households which is in contradiction with government's aim to reduce inequality (National Treasury, 2022:1). Progressive tax is intended to address inequality as it subjects higher income earners to higher rates of taxes and imposes lower rates of taxes on lower income earners (Inchauste *et al.*, 2015). South Africa currently taxes personal income tax on a progressive system. This system is showcased by the increased tax rates for increasing taxable incomes in Table 4 below.

Table 4: South African income tax rates for individuals 2023 tax year

Taxable income (R)	Rates of tax (R)
1 – 226 000	18% of taxable income
226 001 – 353 100	40 680 + 26% of taxable income above 226 000
353 101 – 488 700	73 726 + 31% of taxable income above 353 100
488 701 – 641 400	115 762 + 36% of taxable income above 488 700
641 401 – 817 600	170 734 + 39% of taxable income above 641 400
817 601 – 1 731 600	239 452 + 41% of taxable income above 817 600
1 731 601 and above	614 192 + 45% of taxable income above 1 731 600

Source: (South African Revenue Service, 2022)

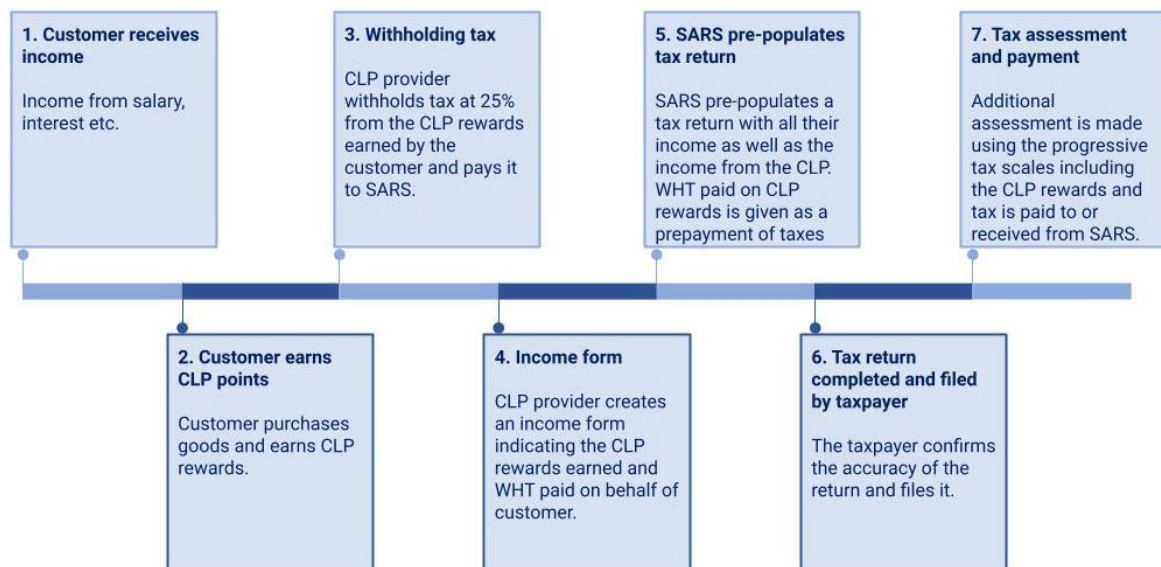
Table 4 above illustrates that the tax rates for individuals in South Africa increase progressively based on income. For these reasons, Pidduck *et al.* (2019:643) proposed a progressive WHT (where the WHT would serve as a prepayment of taxes) as a solution for taxing CLP rewards in an equitable manner.

A progressive WHT of this sort would rely on current systems in place at SARS. In this regard, the Act contains a WHT mechanism in Section 35A that requires a resident, who purchases immovable property situated in South Africa from a non-resident, to withhold a percentage of the purchase price (ranging between 7.5% and 15% depending on the nature of the non-resident) and pay it over to SARS. The amount withheld serves as an advance of the normal tax liability of the seller.

The proposed progressive WHT on CLP rewards would work on the same principle. In essence, the CLP provider would be required to withhold an upfront flat rate WHT on CLP

rewards and pay it over to SARS. The provider would then issue a tax certificate for each customer indicating the value of rewards earned by the customer and the corresponding WHT paid on such amount. These tax certificates would then be pre-populated into the taxpayer's individual tax return. SARS currently has measures such as IRP 5 forms and IT3(b) forms which it obtains from taxpayer's employers and institutions such as banks and financial services offerors which are utilised to prepopulate a taxpayer's tax return. Thus the proposal made by the researcher (and supported by Pidduck *et al.* (2019:639)'s proposal for the introduction of a similar form) would rely on current systems in place at SARS. Upon the pre-population of the individual customer's tax return, they will get an additional assessment on the CLP rewards. Alternatively, if their progressive tax rate is lower than that of the WHT rate, the difference would be offset against their tax payable or refunded. This approach is illustrated in Figure 6 below.

Figure 6: Proposed mechanism for collecting tax on CLPs



Source: Own design

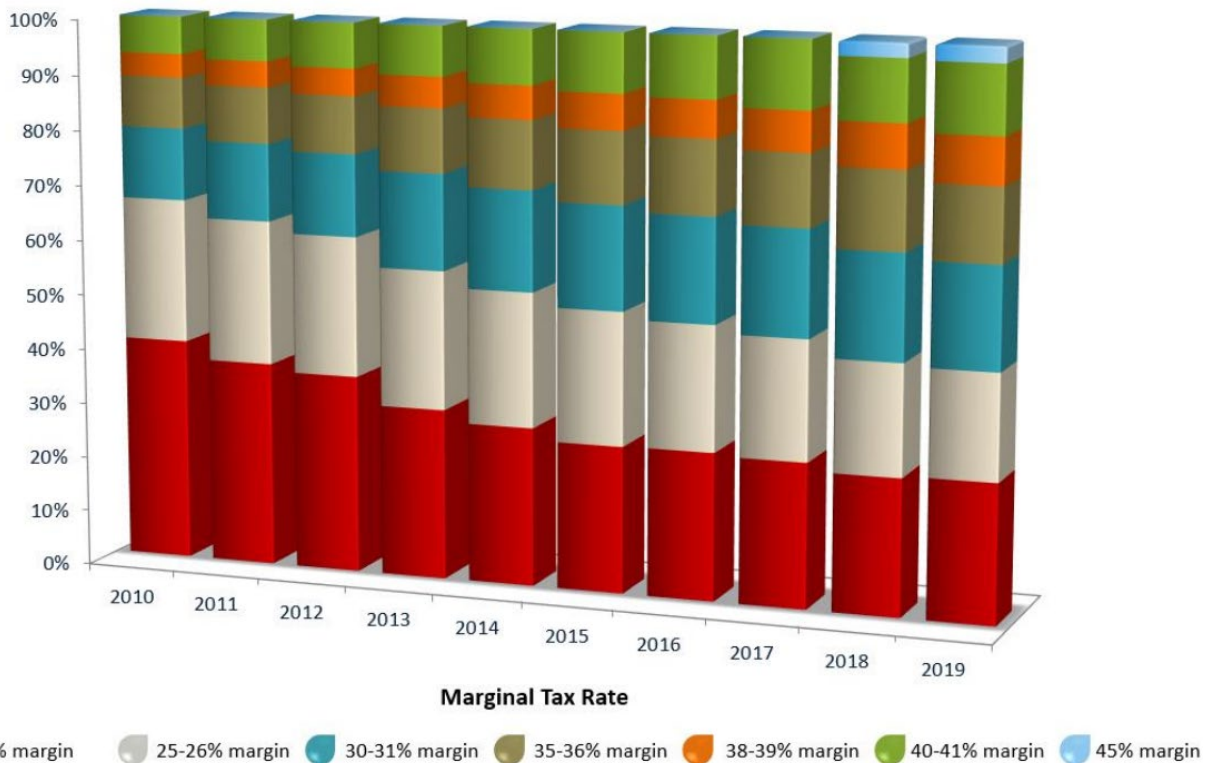
Figure 6 illustrates the proposed process to collect a progressive WHT on CLP rewards earned by customers. It is seen that a customer earns income from their salary and other sources, after which they purchase goods and earn CLP rewards. These rewards are subject to a WHT at the point of sale of the related goods. The CLP provider completes an income form indicating the value of rewards earned by the customer and the amount of WHT withheld from the customer. Subsequently, SARS utilises this income form to calculate the customer's taxable income. Based on the customer's income and the progressive tax rate

applicable to them, they will either receive an additional assessment for tax or receive a rebate when the WHT rate is higher than their tax rate.

After understanding the proposed mechanism for collecting the tax on CLP rewards, the question arises as to what rate for a WHT would be appropriate. It is therefore valuable to inspect the rates of other WHT in the Act. Currently, WHT on interest is at a rate of 15% as contained in Section 50B of the Act. WHT on dividends is contained in Section 64 of the Act and is charged at a rate of 20%. Likewise, WHT on royalties as contained in Section 49B of the Act is charged at 15%.

Prior research by Pidduck *et al.* (2019:643) proposed a WHT rate of 25%. The lowest applicable rate on the income tax sliding scale is 18%. It would not make administrative sense to impose a WHT lower than 18%, as it would drastically increase the number of taxpayers that would need to pay tax on their CLP rewards upon assessment, resulting in deferred cash flows for SARS. The spread of taxpayers over the various tax brackets is illustrated below.

Figure 7: Proportion of the 2.9 million taxpayers by marginal tax rates, 2010-2019



Source: (National Treasury & South African Revenue Service, 2021:25)

As seen in Figure 7 above, in the 2019 tax year, 60% of South African taxpayers were taxed at a rate of between 18% and 31%, thus the most sensible conclusion would be that a WHT rate must be within these margins. The midpoint between these two rates is 24.5% and prior research on CLPs by Pidduck *et al.* (2019:643) suggested a WHT rate of 25%. Furthermore, a 25% rate is currently used to withhold tax from part-time and non-standard employees on their balance of remuneration (Stiglingh, Koekemoer, Van Heerden, Wilcocks & Van der Zwan, 2021:296). The use of a 25% WHT rate for CLP rewards would therefore aid in relieving the additional tax liabilities of higher income individuals upon receipt of their tax assessment and does not digress from that withheld from part-time and non-standard employees on their balance of remuneration. The sensible conclusion to be reached is that a 25% WHT is reasonable for the purposes of this study.

2.7. CONCLUSION

Chapter 2 provided an explanation of how typical CLPs operate in South Africa, whereafter a description of the Smart Shopper programme was provided. It is evident that CLPs are not homogenous in their terms and conditions or operations. For the purposes of this study, a CLP is those loyalty programmes that do not charge a membership fee and who do not offer immediate discounts. Hence, in order for a CLP to be applicable in this study, it must be one where customers earn CLP rewards by using their loyalty card and these rewards are later redeemed in cash or utilised against future purchases.

Although Smart Shopper consists of two distinct components, one being the earning of points and the second being upfront discounts and promotions, only the earning of points (CLP rewards) meet the requirements of a CLP for the purposes of this study. Furthermore, Smart Shopper operates in a similar way to other CLPs, however, it also contains various distinguishing features. The analysis revealed that Smart Shopper differs from other CLPs *inter alia* on how much spending is required to earn points, the value of a point, the point balance needed before redemption, conversion into cash, redemption at third parties, donation of points, as well as expiry of rewards. Therefore, it was concluded that an individualised analysis of Smart Shopper points awarded to customers against the gross income definition in the Act is required.

In the process of the above analysis, it was determined that there is a quantifiable amount being accrued to and later received by CLP customers in the form of reward points in respect

of Smart Shopper. However, there is uncertainty regarding at what time these points accrue to the customer as well as whether or not these CLP rewards are of a capital or revenue nature. Therefore, for the purpose of this study, the researcher will apply the recommendations made by Swanepoel and Pidduck (2020:96), that CLP rewards earned by customers of CLPs (including Smart Shopper) are subject to a special inclusion into gross income that overrides the capital or revenue inquiry and specifies that accrual takes place at the time when the CLP rewards are earned.

Furthermore, a discussion followed on the proposed WHT system where the CLP provider withholds 25% on points issued to Smart Shopper customers and completes an income form indicating the value of rewards earned by the customer and the amount of WHT withheld from the customer. Subsequently, SARS utilises this income form to calculate the customer's taxable income. Based on the customer's income and the progressive tax rate applicable to them, they will either receive an additional assessment for tax or receive a rebate when the WHT rate of 25% is higher than their tax rate.

The findings made in Chapters 1 and 2 therefore conclude Phase 1 of this study. The findings of this phase are used in Phase 2 that is contained in Chapter 3. Phase 2 provides an analysis of the accounting disclosures of Smart Shopper that allow the researcher to quantify the tax on CLP rewards of Smart Shopper customers.

CHAPTER 3: DATA ANALYSIS AND RESULTS

3.1. INTRODUCTION

The aim of this study is to quantify the potential tax revenues from the taxation of CLP rewards received by customers, as applied to the Smart Shopper CLP. The focus of Chapter 2 was that of providing an overview of the operation of CLPs and the Smart Shopper, as well as an analysis of the gross income definition's applicability to the Smart Shopper. In this chapter an understanding of the relevant accounting treatment and disclosure prescribed by IFRS is provided in order to facilitate the quantification of the potential tax revenues from Smart Shopper. In doing so the financial information relating to Smart Shopper CLP rewards are extracted and analysed from the financial statements of Pick n Pay from 2018 to 2021. Chapter 3 therefore comprises Phase 3 of the study and encompasses the longitudinal case study and data analysis.

3.2. UNDERSTANDING THE ACCOUNTING TREATMENT

After understanding the typical operation of a CLP as contained in Chapter 2 (Phase 2 of the study), the accounting treatment may be described with reference to IFRS 15. The accounting treatment of CLP benefits is prescribed by IFRS 15 that mandates that revenue from awarding rewards in CLPs must be separately recognised and disclosed, which was not the case in the previous accounting standard, IFRIC 13 (IASB, 2021 para B39-B89). The accounting of revenue prescribed by IFRS 15 may be summarised into five steps (IASB, 2021:A890):

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

A brief description of the operation of these steps, followed by an example for illustration purposes is included below.

Step 1 provides guidance with regard to identifying contracts and customers, while Step 2 indicates how performance obligations must be identified. A performance obligation is each promise in the contract to transfer a good or service to the customer (IASB, 2021:A931).

Step 3 provides guidance on determining the price of the transaction, while Step 4 indicates how the total transaction price must be split amongst performance obligations. Step 5 indicates when revenue may be recognised. The general principle for accounting purposes is that revenue may only be recognised once the benefits have been transferred to the customer. Specific guidance for the application of IFRS 15 to CLPs is given in Appendix B to the standard (IASB, 2021 para B39-B42).

In brief, IFRS 15 indicates that the sale of goods and the earning of CLP rewards are two separate performance obligations (IASB, 2021 par B40). The transaction price is considered the full price of goods sold and must be allocated between the two performance obligations, namely (1) the sale of goods and (2) the CLP rewards awarded to the customer (IASB, 2021 para B42). Revenue relating to the sale of goods may be recognised upon time of the sale, but the portion of revenue allocated to CLP rewards must be recognised as a 'contract liability' and may only be recognised as revenue when the rewards have been utilised by the customer (redeemed) or have expired (IASB, 2021 para 31).

A 'contract liability' is the IFRS 15 term used for the 'liability' that is created for an entity's obligation to transfer goods or services to a customer for which payment has already been received by the company (IASB, 2021:A931). IFRS 15 requires that a portion of the consideration from the transaction be allocated to the awarding of CLP rewards as a form of deferred revenue since the consideration for these rewards is deemed to have already been received. Therefore, the provider has an obligation to transfer the CLP rewards to the customer and the contract liability is necessary to account for this obligation. Essentially, the contract liability is an account to temporarily store the value of CLP rewards as these are 'owed' to the customer (IASB, 2021 para B39-B42).

Notwithstanding the above, it is evident that the contract liability will become revenue in the hands of the provider at a future date, either upon redemption by the customer or expiry of the points. The value of the revenue relating to the CLP rewards is based on the provider's expectation of how much of the CLP rewards will be exercised or redeemed during the financial year. This expectation is determined by each individual provider by analysing past redemption of CLP rewards to predict future redemption, however IFRS does not provide detailed guidance on how this estimate must be made (IASB, 2021 para B46). Moreover, the CLP reward revenue may only be recognised as revenue when this reward is exercised (redeemed by the customer) or has expired (IASB, 2021 para 31).

A short example to aid the explanation of the contract liability recognised for the awarding of CLP benefits follows:

Example 1

Facts

Company A operates a CLP where customers obtain 10 reward points for each R100 spent, each reward point is valued at R1. At the start of their financial year, Company A has an opening balance of R200 on their contract liability. During the current financial year, the customers purchased R3 000 worth of goods. It is expected that only 90% of CLP reward points earned will be redeemed in future. This expectation is based on past experience of Company A. During the current financial year R250 was recognised as revenue relating to the CLP rewards.

Disclosure

Company A would be required to disclose the R200 opening balance of the contract liability and add the additional allocation of CLP reward points (as a result of purchases made during the year by customers) to this contract liability balance.

Calculation of additional CLP reward points expected to be utilised:

In this example the portion of the purchases made by customers (R3 000) must be allocated to the contract liability and is calculated as follows:

- The ratio of allocating CLP reward points is 10 reward points for every R100; thus customers earn 300 reward points on these purchases (R3 000 spent X 10 points / R100). However, Company A only expects 90% of CLP reward points to be redeemed by customer, therefore only 90% of the CLP reward points earned must be included in the contract liability. Therefore, the CLP reward points expected to be redeemed are calculated at 270 points (300 points earned X 90%). As 1 point is valued at R1, the 270 points are equal to R270.

Proration between contract liability and revenue

Although customers pay R3 000, they obtain goods valued at R3 000 and CLP reward points valued at R270. Therefore, the R3 000 payment must be pro-rated between the

revenue and the contract liability. In order to prorate the R3 000 received from customers in this example, the proration is calculated as follows for the example:

- The total value given to customers is R3 270 (R3 000 purchases + R270 of CLP reward points expected to be redeemed). However, the value that may be recognised is limited to the R3 000 of goods sold and therefore the value allocated to CLP reward points expected to be redeemed is also limited to R248 ($R3\ 000 \times R270 / R3\ 270$) which will be added to the contract liability for accounting purposes.
- Furthermore, the value allocated to revenue from sales is R2 752 ($R3\ 000 \times R3\ 000 / R3\ 270$) which will be recognised as revenue from sale of goods for accounting purposes.

Disclosure and calculation of CLP reward points utilised

Once the value of CLP reward points expected to be utilised in the current year has been added to the contract liability, the CLP reward points utilised and expired in the current year must be deducted from the contract liability. In this example R250 of revenue was recorded resulting from the CLP which consists of reward points redeemed and expired. In this example the closing balance of the contract liability is calculated as follows: R198 (R200 opening balance plus R248 awarded and expected to be utilised less R250 redeemed and expired).

The calculation and disclosure of the contract liability as described in the Example 1 is provided in Table 5 below.

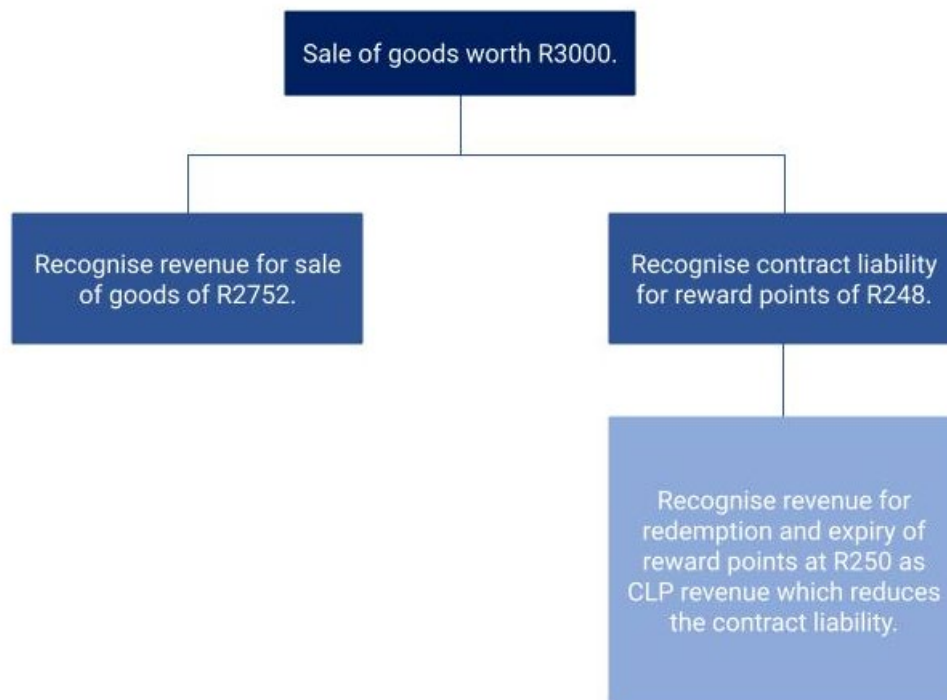
Table 5: Example of IFRS 15 implications

Reconciliation of movement in the contract liability account		Rand
A	Opening balance of the contract liability	200
B	Plus, CLP reward points earned in the current year that are expected to be utilised.	248
C	Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired)	(250)
D	Equals closing balance of the contract liability	198

Source: Own design

A summary of the revenue and contract liability as described in Example 1 is illustrated in Figure 8 below.

Figure 8: Illustration of IFRS 15



Source: Own design

Example 1 illustrates the calculation, proration and disclosure requirements as required by IFRS 15 in respect of typical CLPs. For purposes of quantifying the tax revenues as discussed in Section 2.6 of this study, the WHT of 25% would be applied to the CLP reward points issued during the year (represented by R300 in Example 1 above).

3.3. DATA ANALYSIS

Following the above understanding of the accounting treatment and disclosures, the financial statements of Pick n Pay are analysed to quantify the CLP reward points issued by Smart Shopper from 2018 to 2021. Although the discussion of IFRS 15 refers to a “contract liability”, Pick n Pay refers to this liability as “deferred revenue”. Upon analysis of the financial statements of Pick n Pay it was identified that the opening and closing balance of the deferred revenue (equivalent to rows A and D in Table 5 above) were disclosed. However, the revenue recognised during the current year relating to the deferred revenue (row C in Table 5 above) as well as the points earned and expected to be utilised (row B in Table 5 above) are not disclosed. This lack of disclosure necessitates the use of calculations

by the researcher to obtain reasonable values for these items using the disclosure available in the financial statements. While these calculations introduce a limitation to this study the process used to determine the CLP rewards issued by Smart Shopper in the respective years is discussed below. Table 6 below illustrates the data collected from Pick n Pay's financial statements.

3.3.1. CLP REWARDS ISSUED BY SMART SHOPPER

Table 6: Data analysis from financial statements of Pick n Pay

Financial year	2018	2019	2020	2021	
R million					
A	Smart Shopper deferred revenue opening balance	137.4	121.3	96.9	122.9
B	Plus, points issued and expected to be utilised	Not disclosed separately			
C	Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired)	Not disclosed separately			
D	Equals Smart Shopper deferred revenue closing balance	121.3	96.9	122.9	170.6

Source: Own design using financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78)

Table 6 presents a reconciliation similar to the reconciliation contained in Table 5 (example for illustrative purposes). However, it is evident that row B and C (points issued and expected to be utilised and revenue recognised from CLP reward points) are required to complete the reconciliation and therefore calculations are required to determine these amounts.

Nevertheless, the financial statements of Pick n Pay do contain some disclosure regarding the revenue recognised during the year from deferred revenue (indicated in Table 7 below); however, the amount disclosed relates to all deferred revenue (including that of prepaid gift card liability, Smart Shopper loyalty programme liability and refund liability as indicated in Table 7 and Table 8 below). Therefore to calculate the amount of revenue (indicated by row C of Table 5 and Table 6 above) from the Smart Shopper CLP that represents the value of

points that have been redeemed and expired during the year, prorations were performed in Tables 7, 8 and 9 below to obtain such amounts.

Table 7: Pick n Pay revenue recognised from deferred revenue

Financial year	2018	2019	2020	2021
	R million			
Revenue recognised from total deferred revenue	164.9	177.8	134.6	221.3

Source: Own design using financial statement data (Pick n Pay Stores Limited, 2019:43; Pick n Pay Stores Limited, 2020:48; Pick n Pay Stores Limited, 2021a:47)

The values indicated in Table 7 represent the amount disclosed in Pick n Pay's financial statements for revenue recognised during a given year that was previously recognised as deferred revenue. This revenue however relates to all types of deferred revenue which in Pick n Pay's financial statements include prepaid gift cards, the Smart Shopper programme and refund liabilities. In order to separate the revenue recognised for each item of deferred revenue, the closing balance of the prior year was used to prorate the deferred revenue in each successive year, thereby calculating a proportional or weighted value of each type of deferred revenue. This proration is shown in Table 8 below.

Table 8: Pick n Pay deferred revenue liability

Financial year	2018	2019	2020
	R million (unless stated otherwise)		
A Prepaid gift card liability	138.0 *49.1%	136.1 *53.1%	152.6 *51.1%
B Smart Shopper loyalty programme liability	121.3 *43.1%	96.9 *37.8%	122.9 *41.1%
C Refund liability	22.0 *7.8%	23.2 *9.1%	23.3 *7.8%
D Total deferred revenue	281.3	256.2	298.8

Source: Own design using financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78) * Percentages calculated by the researcher

Row A to C in Table 8 indicates the deferred revenue liability balance at the end of the year for each respective deferred revenue item, while row D in Table 8 indicates the total deferred revenue balance for the year. The percentages calculated in the table is the ratio of a specific deferred revenue item in relation to the total deferred revenue. No percentage is calculated in the 2017 financial year to use in the apportionment of the 2018 financial year revenue as the 2017 year has insufficient disclosure relating to deferred revenue. These percentages are now used in Table 9 below to determine the amount of revenue recognised as it relates to the Smart Shopper programme. It is important to note that the percentages calculated in Table 8 are those used to calculate the revenues for each type of deferred revenue in each subsequent year.

Table 9: Apportionment of revenue to Smart Shopper programme

Financial year		2018	2019	2020	2021
A	Percentage of Smart Shopper deferred liability to total deferred revenue (Table 8)	**40.7%	43.1%	37.8%	41.1%
B	Multiplied by revenue recognised from deferred revenue (Table 7)	164.9	177.8	134.6	221.3
C	Revenue recognised from deferred revenue of Smart Shopper programme	67.1	76.6	50.9	91.0

Source: Own design using financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78) ** Calculated as an average of the percentages of 2019 to 2021.

Table 9 applies the percentages calculated in Table 8 to the revenue recognised in Table 7 to calculate the value of revenue recognised as related to the Smart Shopper programme (equivalent to row C in Table 5). In order to complete Table 6, the value of revenue recognised as calculated above is included in Table 10 below.

Table 10: Partial completion of Table 6 with revenue recognised during the year

Financial year		2018	2019	2020	2021
R million					
A	Smart Shopper deferred revenue opening balance (refer to Table 6 and disclosed)	137.4	121.3	96.9	122.9
B	Plus, points issued and expected to be utilised	Not disclosed separately			
C	Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired) (Table 9)	67.1	76.6	50.9	91.0
D	Equals Smart Shopper deferred revenue closing balance (refer to Table 6 and disclosed)	121.3	96.9	122.9	170.6

Source: Own design (Row A and D: (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78))

Table 10 illustrates the further completion of Table 6, by illustrating the addition of values for row C (revenue recognised from CLP reward points) as calculated in Table 9. For the purpose of this study, CLP reward points received by or accrued to a customer is the object to be taxed. As established in Chapter 2, accrual occurs first when points are issued to a customer and therefore issue of points must be taxed (row B of Table 6 and Table 10). While the points issued during each year that are expected to be redeemed or utilised or expire are not disclosed in the financial statements of Pick n Pay, sufficient information is now available to calculate this value as illustrated in Table 11 below.

Table 11: Completed Table 6 indicates points issued and expected to be redeemed

Financial year		2018	2019	2020	2021
R million					
A	Smart Shopper deferred revenue opening balance (refer to Table 6 and disclosed)	137.4	121.3	96.9	122.9
B	Plus, points issued and expected to be utilised	51.0	52.2	76.9	138.7
C	Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired) (refer to Table 9)	67.1	76.6	50.9	91.0
D	Equals Smart Shopper deferred revenue closing balance (refer to Table 6 and disclosed)	121.3	96.9	122.9	170.6

Source: Own design (Row A and D: (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78))

Row B in Table 11 is calculated as the balancing amount of the reconciliation presented in the example in Table 5. The values in Row B represent the full value of points issued less the points expected to expire. However, an adjustment for expected forfeiture is required as all Pick n Pay disclosures exclude expected forfeiture rates in their financial statements. These rates represent the percentage of CLP reward points that Pick n Pay expects to not be redeemed by its CLP customers, thus being forfeited, and recognised as revenue. IFRS 15 provides that such expected forfeited CLP reward points are to be recognised as revenue at the date of sale of goods on which the CLP reward points were earned (IASB, 2021 para B46). Therefore, to calculate the value of all of the points issued in each year the effect of the disclosed forfeiture rate must be removed. The expected forfeiture rates are indicated in Table 12 below.

Table 12: Expected forfeiture rate

Financial year		2017	2018	2019	2020	2021
A	100% of CLP points issued	100%	100%	100%	100%	100%
B	Less expected forfeiture rate disclosed	15.9%	12.9%	17.5%	17.5%	15%
C	Equals CLP rewards issued adjusted for expected forfeiture	84.1%	87.1%	82.5%	82.5%	85%

Source: Own design using financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78)

A 100% would represent the full value of points issued before expected forfeiture. Therefore, row C in Table 12 represents the percentage of CLP points issued after excluding the effect of forfeiture. However, forfeiture rates are applied to all items in the reconciliation in Table 11 and the rates applied differ between the individual items due to changes in expectations of management (in relation to forfeiture) between different financial years. An average of CLP rewards issued as adjusted for expected forfeiture rate is calculated below in Table 13. This average rate is applied in the calculation of the number of points issued in each year by Smart Shopper.

Table 13: Average CLP rewards issued adjusted for expected forfeiture

Financial year		2018	2019	2020	2021
A	CLP rewards issued adjusted for expected forfeiture at the beginning of the year (refer to Table 13)	84.1%	87.1%	82.5%	82.5%
B	CLP rewards issued adjusted for expected forfeiture at the end of the year (refer to Table 13)	87.1%	82.5%	82.5%	85%
C	Average CLP rewards issued adjusted for expected forfeiture for the year	85.6%	84.8%	82.5%	83.8%

Source: Own design

Table 13 calculates the rate of CLP rewards issued adjusted for expected forfeiture to be applied to the financial data by determining the average of the rate applied at the beginning of the year (Row A in Table 13) and the rate applied at the end of the year (Row B in Table

13). Subsequently, the rate contained in Row C of Table 13 may now be applied in Table 14 below.

Table 14: Points issued by Smart Shopper (excluding expected forfeiture)

Financial year		2018	2019	2020	2021
A	Points issued and expected to be utilised (refer to Row B Table 11) (R million)	51.0	52.2	76.9	138.7
B	Divided by the average CLP rewards issued adjusted for expected forfeiture rate (refer to Row C of Table 13)	85.6%	84.8%	82.5%	83.8%
C	Equals Value of points issued (R million) excluding expected forfeiture	59.6	61.6	93.2	165.5

Source: Own design using calculations from financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78).

In Table 14, the value of points issued by Smart Shopper is calculated by adjusting for expected forfeiture rates. It is important to note that although these calculations performed are arithmetically correct, the financial statements disclosure was limited. Nonetheless, sufficient data is available to make a reliable estimate despite the lack in specific disclosures. The estimates made represent the researcher's best estimate of points issued with the available disclosures. The last row of Table 14 therefore showcases the value of all points that were issued by Smart Shopper in each respective year. Since the researcher does not have access to Pick n Pay's internal financial information, it is not possible to determine the original value of points issued as the separate value of goods sold and points allocated (as indicated in Example 1). Nonetheless, the researcher used reliable methods of computing the value of points issued and reliable estimates were made. Appendix A reflects an alternative calculation of the value of point issued excluding expected forfeiture. The variances between the calculation used in this study and Appendix A is not significant. Therefore, since the value of points issued in each respective year is now available, the researcher is able to continue with the quantification of the tax revenue forgone by applying the WHT rate to this value as is done below.

3.3.2. APPLICATION OF TAX RATE

Row C of Table 14 contains the value of points issued that is to be used as the basis for the gross income amount accrued to customers. The researcher may now commence with Phase 3 by applying the WHT as described under Chapter 2 (Phase 2). The WHT at a rate of 25% is applied to the value of points issued to obtain the value of the potential tax revenues from CLP points. This calculation is showcased in Table 15 below.

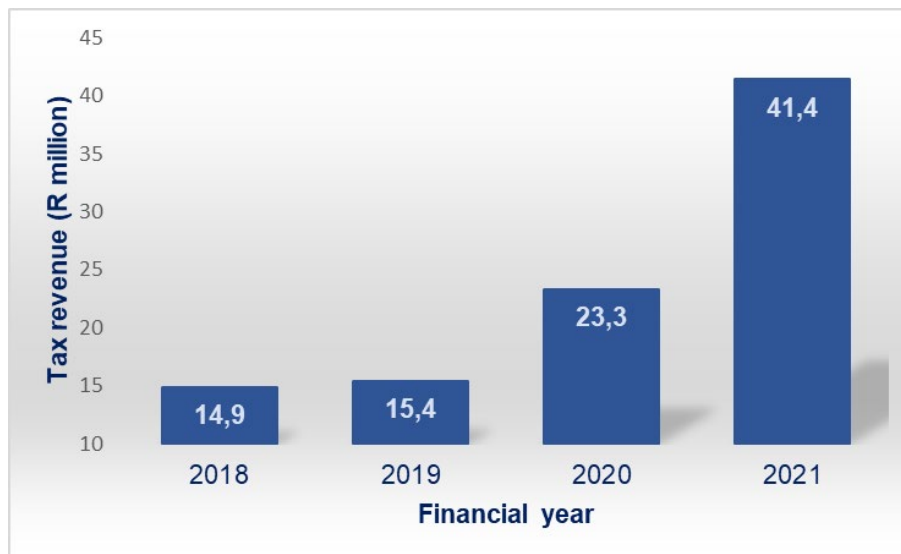
Table 15: Application of WHT

Financial year	2018	2019	2020	2021
Value of points issued (R million) as calculated in Row C of Table 14	59.6	61.6	93.2	165.5
Multiplied by WHT rate	25%	25%	25%	25%
Equals tax revenue (R million)	14.9	15.4	23.3	41.4

Source: Own design

Table 15 therefore calculates the potential tax revenue by multiplying the value of points issued by Smart Shopper as calculated in Table 14 with the WHT rate. Therefore, the potential tax revenues that could be collected from Smart Shopper customers would be R14.9 million in 2018, R15.4 million in 2019, R23.3 million in 2020 and R41.4 million in 2021. In aggregate for the financial years 2018 until 2021, the South African *fiscus* could have collected an estimated R95 million in WHT tax revenue had the CLP rewards earned by customers of Smart Shopper been taxed as proposed. These values are visually represented in Figure 9 below.

Figure 9: Smart Shopper tax revenue



Source: Own design

As indicated in Chapter 1 an increase in tax of up to R40 billion would be needed to help stabilise public debt and return public finances to a sustainable portion over the four years following 2020 in order to get the economy running smoothly again (National Treasury, 2021b:39). The taxation of CLP rewards would aid the achievement of this goal as R95 million could have been collected between 2018-2021 from just one CLP (Smart Shopper). Therefore, 0.24% of the amount needed to stabilise public debt may be collected from a single CLP in South Africa over a four-year period.

Nevertheless, as the proposed WHT of 25% (refer to Section 2.6) represents a prepayment of the amounts taxed on each individual customer's taxable income, this total WHT is not adjusted for the progressive income tax rate that would be applied upon assessment. The South African progressive tax rates on income tax range between 18% and 45%. Therefore, the tax revenue of R95 million may be 7% lower should it be levied upon lower income earners. However, higher income earners would pay an additional 20% tax on the CLP rewards earned. In light of the fact that wealthier households have greater participation in CLPs (refer to Section 2.2) it is likely that the tax revenue calculated above is conservative. Therefore, the proposed tax will have a lower impact on poorer households due to lower levels of participation in CLPs, which is consistent with the conclusions drawn by Pidduck *et al.* (2019:641). Similarly, it is notable that this study is also limited to that of just one CLP, namely the Smart Shopper, and it is expected that such tax revenues from one CLP may be

an indicator of that of the rest of the population. Therefore, significant tax revenues may be gleaned from the taxation of other CLPs not included in the scope of this study.

Notwithstanding the above, it is crucial to evaluate whether the benefit obtained by SARS from collecting taxes on CLP rewards in this manner outweighs the costs thereof to determine whether such a system is feasible. Therefore, the researcher has identified the following benefits that would be obtained from the implementation of the proposed method of taxation:

- The introduction of a special inclusion into the Act will limit judicial overload.
- The proposed system utilises current structures in place at SARS (such as the WHT on immovable property system) which results in a significantly lower administrative burden than that which is imposed in alternative methods such as direct inclusion into each individual customer's tax return without the aid of a WHT mechanism.
- The proposed system allows for government to benefit from the prepayment of taxes while also imposing a progressive tax as is consistent with the South African government's progressive system of taxation.
- This system further lessens the administrative burden on taxpayers as a whole, as fewer entities (being CLP providers, in this case Pick n Pay), would collect taxes and file forms for 8.5 million taxpayers. This proposed system removes the need for self-assessments and reduces the likelihood of non-compliance due to error or manipulation in the calculation of taxes.
- The proposed system improves tax compliance and reduces tax avoidance as seen in Section 2.6 when a WHT is implemented, and a near 99% tax compliance is reached (Thomas, 2019:90).
- Lastly, the implementation of the proposed system would increase the South African tax base and aid in lowering the South African budget deficit. It also addresses the imbalance currently in place due to providers receiving a deduction for CLP rewards but no tax being implemented on customers.

However, despite the above benefits, the proposed method does not take into account the impact on the willingness of consumers to participate in CLPs as a result of the taxes implemented. Higher income taxpayers in particular may resist the tax on CLP rewards, however they are in a better position than lower income earners to provide for such tax due to their higher income (Pidduck *et al.*, 2019:641). The imposition of the WHT mechanism

and the pre-population of tax returns (refer to Section 2.6) may decrease resistance to the implementation of this proposed system and therefore the effective progressive tax rate may result in much higher tax revenue than calculated above.

3.4. CONCLUSION

This chapter provided an understanding of the relevant accounting treatment and disclosure prescribed by IFRS that applies to Smart Shopper. Thereafter the required data was extracted from the financial statements of Pick n Pay for the financial years of 2018 until 2021. This data was used to calculate the cumulative potential tax revenues that would result from the taxation of CLP rewards earned by customers of Smart Shopper. The analysis revealed a cumulative tax revenue of R95 million for the financial years 2018 until 2021 at the WHT rate of 25%. However, since the proposed system aims to ultimately tax customer's CLP rewards at their progressive tax rate, it is expected that this is a conservative value.

Similarly, the findings revealed that a single CLP in South Africa (Smart Shopper) would contribute 0.24% of the amount needed to stabilise public debt. Additional benefits to be obtained by the implementation of the proposed system for a tax on CLP rewards is increased tax collection while maintaining taxation at a progressive rate, decreased non-compliance, increased tax base and lower need for self-assessments by individuals as discussed in Section 3.3.

Hence, Chapter 3 herewith concludes Phase 3 of this study and meets the objective of this study by quantifying the potential tax revenue from the taxation of CLP rewards by customers of Smart Shopper. Chapter 4 below contains a conclusion of this study by showcasing the findings and meeting of the research objectives.

CHAPTER 4: CONCLUSION

4.1. INTRODUCTION

As discussed in Chapter 1, the South African *fiscus* is in dire need of additional tax revenue collections. The aim of this study was to quantify the potential tax revenues from the taxation of CLP rewards received by customers, as applied to the Smart Shopper CLP. In order to achieve the objectives and to answer the research question, a longitudinal instrumental case study approach was followed as the methodology (described in Section 1.6). This chapter concludes on each of these objectives and provides a conclusion for this study.

4.2. ACHIEVEMENT OF RESEARCH OBJECTIVES

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

- 1. Define the characteristics of a CLP for the purposes of this study that would result in rewards potentially being subject to tax in the hands of the customers under the Gross Income definition in the Income Tax Act No. 58 of 1962.**
- 2. Analyse the terms and conditions of the most widely used loyalty programmes in South Africa to determine whether they meet the defining characteristics of a CLP for the purposes of the study.**
- 3. Analyse the annual financial statements of the providers of the selected CLPs in order to quantify the value of the CLP rewards issued to customers.**
- 4. Quantify the cumulative potential tax revenues forgone by the South African *fiscus* as a result of not taxing CLP rewards.**
5. Compare the taxation of CLPs to other jurisdictions using authoritative literature.
6. Analyse the terms and conditions of the most widely used CLPs in South Africa to determine whether they meet the defining characteristics of the charging section for the purposes of Value-Added Tax in South Africa.

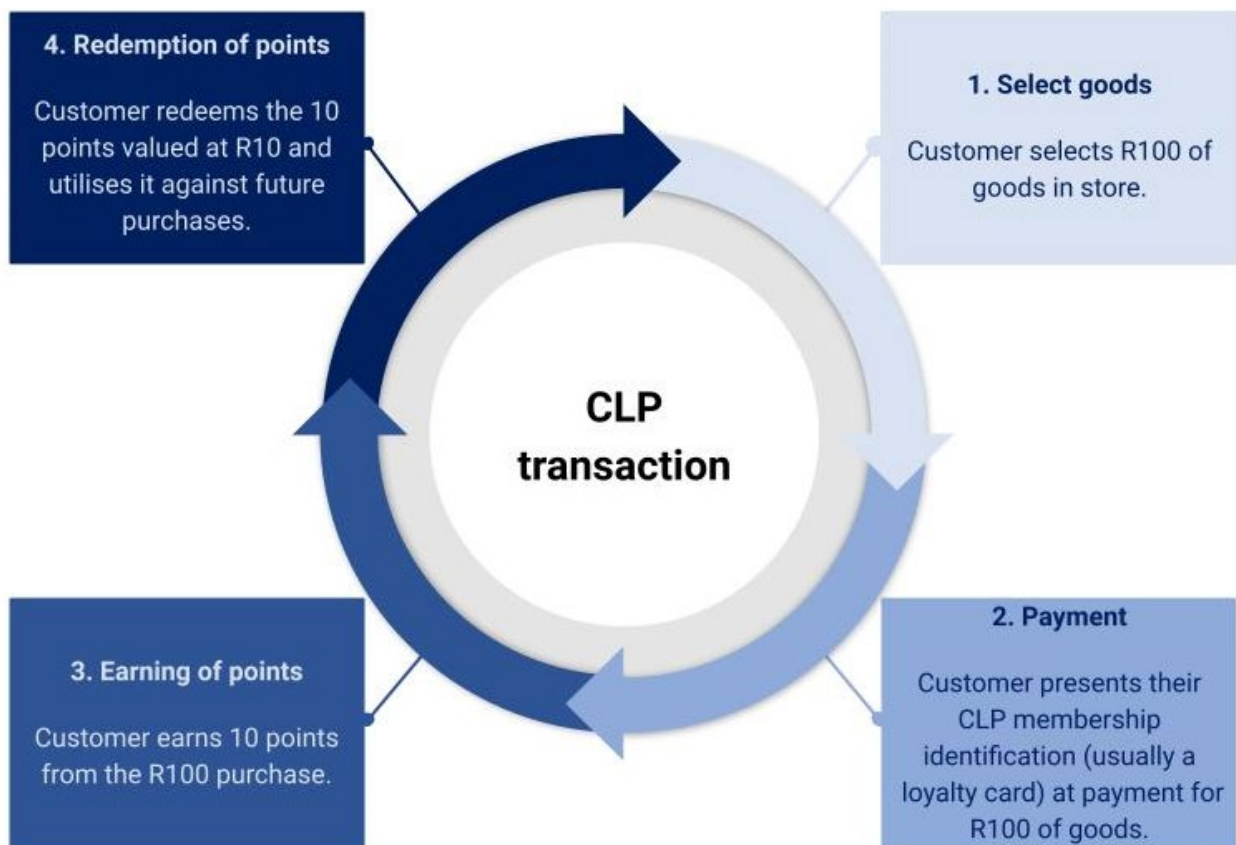
This study focused on quantifying the potential tax revenues from the taxation of CLP rewards earned by users of one particular CLP, namely Smart Shopper (refer to Section 1.6.4 for the selection process of CLPs used in this and the greater study). The results of this study contribute to that of the greater study. This study is limited in scope to Objectives 1-4 as set out above. The greater study includes additional CLPs as part of Objectives 1-4, as well as Objectives 5 and 6 that were not addressed in this particular study. The

achievement of each research objective as achieved in this study is discussed individually below.

4.2.1. DEFINING THE CHARACTERISTICS OF CLPs

The background and rationale of this study in Chapter 1 provided an introduction to the CLP landscape and its importance in the South African context. Nevertheless, the characteristics of a CLP for the purposes of this study were defined in Section 2.2 as those loyalty programmes that do not charge a membership fee and do not offer immediate discounts. Therefore, in order for a CLP to be applicable in this study, it must have been one in which customers earn rewards that are later redeemed in cash or utilised against future purchases. The general operation of a CLP for the purposes of this study was illustrated by Figure 4 and is re-represented here in Figure 10 below.

Figure 10: Illustration of a typical CLP transaction



Source: Own design (refer to Figure 4 in Section 2.2)

Figure 10 illustrates that a customer selects goods to purchase, and upon payment they present their CLP membership identification (usually in the form of a loyalty card) and earn

CLP reward points based on the value of the purchase. The customer may usually redeem these CLP rewards in future or utilise them against future purchases.

Subsequent to the determination of the characteristics of a CLP for the purpose of this study, these were tested against the characteristics of the CLP selected, Smart Shopper, to determine whether it was relevant to this study.

4.2.2. APPLYING THE CLP DEFINITION TO SMART SHOPPER

In the case of Smart Shopper, it was identified that the programme does not charge a membership fee but consists of two distinct components. One component is the earning of points and the second component is upfront discounts and promotions. While the upfront discounts are not included in the scope of this study, the earning of points (CLP rewards) is within the scope of this study. Therefore, it was concluded that the earning of points as part of Smart Shopper does meet the definition of a CLP for the purposes of this study (refer to Section 2.3). Moreover, while Smart Shopper operates in a similar way to that of other CLPs, it does contain various distinguishing features including how much spending is required to earn points, the value of a point, the point balance needed before redemption, conversion into cash, redemption at third parties, donation of points, as well as expiry of rewards. Therefore, it was concluded that an individualised analysis of the Smart Shopper against the gross income definition in the Act is required (refer to Section 2.3).

4.2.3. APPLYING THE GROSS INCOME DEFINITION TO SMART SHOPPER REWARDS

In order for Smart Shopper points to be subject to tax, they have to meet the gross income definition in the Act. The 'total amount in cash or otherwise' requirement was met as Smart Shopper rewards have an ascertainable monetary value (a rand conversion rate) namely R1 for every 100 points earned which would represent the value of rewards earned (Pick n Pay Stores Limited, 2022c). Therefore, even though Smart Shopper rewards are not cash and cannot be converted into cash, there is an 'amount' as the rewards are 'otherwise' than in cash (refer to Section 2.4.1).

Furthermore, CLP rewards accrue to the customer as soon as they become available for use by the customer for their own behalf and own benefit. In most instances this occurs before redemption, where the customer exchanges the CLP points for goods or services

(receipt of goods and services). In the case of Smart Shopper, the time of accrual may be considered unclear due to the minimum point balance of 500 points required before a customer may redeem the points. Nevertheless, Smart Shopper customers take receipt of their CLP points as soon as redemption occurs. Therefore, although the exact timing of accrual is unclear, it is clear that accrual does occur before the CLP rewards are beneficially received and thus the Smart Shopper programme satisfies the 'received by or accrued to' requirement of the gross income definition (refer to Section 2.4.2).

However, since the various CLPs present in South Africa have a multitude of terms and conditions impacting the timing of receipt and accrual of rewards, there remains complexity in determining when the 'received by or accrued to' requirement is met. In order to address this complexity, legislative reform is suggested, however, it would be impractical to address each individual CLP in legislation. Therefore, the suggestion of the researcher is that legislation must clarify the timing of receipt or accrual in a uniform manner to address all CLPs and to ensure a single point of taxation amongst the various CLPs present in South Africa (Swanepoel & Pidduck, 2020:92-93).

Moreover, the 'not of a capital nature' requirement must be considered which necessitated a study of the difference between a casual CLP user and a CLP user who purposefully shops at partner retailers in order to earn CLP rewards, actively aiming to obtain a profit or personal gain (Swanepoel & Pidduck, 2020:96). The intention of the customer relating to how they earn their CLP rewards is a determining factor in determining the nature (capital or revenue) of the CLP rewards. However, since the intentions of different customers vary, it is impractical to determine each individual customer's intention. Therefore, it is likely that the best manner to address these complexities is by legislative amendment in the form of a special inclusion to the gross income definition rather than judicial consideration on an individual basis (refer to Section 2.3).

Therefore, the gross income definition was met by Smart Shopper rewards, as there is a quantifiable amount being accrued to and later received by CLP customers in the form of reward points in respect of Smart Shopper. However, there is uncertainty regarding at what time these points accrue to the customer, as well as whether or not these CLP rewards are of a capital or revenue nature. Therefore, for the purpose of this study, the researcher applied the recommendations made by Swanepoel and Pidduck (2020:96), that CLP rewards earned by customers of Smart Shopper are subject to a special inclusion into gross

income that overrides the capital or revenue inquiry and specifies that accrual takes place at the time when the CLP rewards are earned (refer to Section 2.4).

4.2.4. QUANTIFY VALUE OF REWARDS

The analysis of the annual financial statements of Pick n Pay revealed that they disclose the following information:

- Opening balance of deferred revenue relating to the Smart Shopper programme.
- Closing balance of deferred revenue relating to the Smart Shopper programme.
- Revenue recognised during the year originating from the total deferred revenue of prior years.
- The percentage of expected forfeiture of points by Smart Shopper customers.

However, Pick n Pay did not separately disclose the amount of revenue recognised during the year relating to deferred revenue of the Smart Shopper programme in the prior year. Furthermore, they also did not disclose the value of points issued to customers during the year. Therefore, using the values available in the disclosure, a value for revenue recognised during the respective years and the value of points issued (after taking into account the expected forfeiture rate) was calculated.

Thereafter, the value of points issued after taking into account the expected forfeiture rate was adjusted using the disclosed forfeiture rates to calculate the value of Smart Shopper points issued during each financial year (refer to Section 3.3.1). Nevertheless, the researcher did not have access to Pick n Pay's internal financial information, thus it was not possible to determine the original value of points issued with absolute certainty. Therefore, the researcher used reliable methods of computing the value of points issued and reliable estimates were made. Although the value calculated is the best estimate of the amount, the researcher was limited due to the disclosure available in the financial statements. A summarised computation of the value of all points issued for the financial years 2018 until 2021 is contained in Table 16 below.

Table 16: Summarised calculation of points issued by Smart Shopper

Financial year		2018	2019	2020	2021	Source	
		R million (unless stated otherwise)				Table	Row
A	Smart Shopper deferred revenue opening balance	137.4	121.3	96.9	122.9	Table 6	A
B	Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired)	(67.1)	(76.6)	(50.9)	(91.0)	Table 9	C
C	Revenue recognised from deferred revenue	164.9	177.8	134.6	221.3	Table 7	
D	Percentage of Smart Shopper deferred revenue to total deferred revenue	40.7%	43.1%	37.8%	41.1%	Table 8	B
E	Less Smart Shopper deferred revenue closing balance	(121.3)	(96.9)	(122.9)	(170.6)	Table 6	D
F	Equals points issued and expected to be utilised	51.0	52.2	76.9	138.7	Table 11	B
G	Percentage of points issued adjusted for average expected forfeiture	85.6%	84.8%	82.5%	83.8%	Table 13	C
H	Value of points issued	59.6	61.6	93.2	165.5	Table 14	C

Source: Author's own calculated using financial statement data (Row A, C, E directly from financial statements (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78))

Table 16 represents a summary of the computation of the value of points issued by Smart Shopper to their customers using the disclosures from Pick n Pay. The findings reveal that the value of points issued from 2018 to 2021 were R59.6 million, R61.6 million, R93.2 million and R165.5 million respectively. While these values were calculated using the data disclosed in Pick n Pay's financial statements, the researcher was required to make adjustments and estimations for revenue recognised from deferred liability, as well as expected forfeiture rate (refer to Section 3.3.1) which is included as a limitation to this study. In order to determine the pure value of points issued, the researcher requires all information

about Smart Shopper. However, as the researcher did not have access to all of the internal information from Pick n Pay, she made use of publicly available information, such as the annual financial statements of Pick n Pay and disregarded some adjustments as discussed above. The value of points issued to Smart Shopper customers in the respective years were further used in the reaching of Objective 4 as discussed below.

4.2.5. CUMULATIVE POTENTIAL TAX REVENUES

The proposed method for taxation was discussed in Section 2.6 as a WHT system where the CLP provider withholds 25% on all points issued by Smart Shopper as a form of prepayment on behalf of the customer for taxation. Subsequently, SARS utilises this WHT (alongside administrative forms from the provider) to calculate the customer's taxable income. Based on the customer's taxable income and the progressive tax rate applicable to them, they will either receive an additional assessment for tax or receive a rebate when the WHT rate of 25% is higher than their progressive tax rate (refer to Section 2.6). In applying this prepaid WHT to the value of points issued to Smart Shopper customers (refer to Section 3.3.1) the following tax revenues were calculated as illustrated in Table 17 below.

Table 17: Calculation of potential tax revenue from Smart Shopper

Financial year	2018	2019	2020	2021
Value of points issued (R million) as calculated in Row C of Table 14	59.6	61.6	93.2	165.5
Multiplied by WHT rate	25%	25%	25%	25%
Equals tax revenue (R million)	14.9	15.4	23.3	41.4

Source: Author's own (Table 15)

Table 17 indicates the potential tax revenues that could have been collected on the Smart Shopper CLP as R14.9 million, R15.4 million, R23.3 million and R41.4 million from 2018 to 2021 respectively. In aggregate for the financial years 2018 until 2021, the South African *fiscus* could have collected R95 million in WHT tax revenue in relation to the Smart Shopper (refer to Section 3.3.2). As mentioned in Section 1.1, an increase in tax of up to R40 billion would be needed to help to stabilise public debt and return public finances to a sustainable portion over the four years following 2020 in order to get the economy running smoothly again (National Treasury, 2021b:39). Therefore, Smart Shopper alone would

contribute 0.24% of the amount needed to stabilise public debt over a four-year period (refer to Section 3.3.2).

However, since the South African progressive income tax rates range between 18% and 45%, the R95 million tax revenue may be 7% lower should it be levied upon lower income earners. Contrastingly, it may be higher as higher income earners would pay an additional 20% tax on the CLP rewards earned. Moreover, since wealthier households participate in CLPs to a greater extent, it is likely that that the tax revenue calculated above is conservative (refer to Section 2.2).

Notwithstanding the above, it is crucial to evaluate whether the benefit obtained by SARS from collecting taxes on CLP rewards in this manner outweighs the costs thereof to determine whether such a system is feasible. Therefore, the researcher has identified the following benefits that would be obtained from the implementation of the proposed method of taxation:

- The introduction of a special inclusion into the Act would limit judicial overload.
- The proposed system utilises current structures in place at SARS (such as the WHT on immovable property system) which results in a significantly lower administrative burden than that which is imposed in alternative methods such as direct inclusion into each individual customer's tax return without the aid of a WHT mechanism.
- The proposed system allows for government to benefit from the prepayment of taxes while also imposing a progressive tax as is consistent with the South African government's progressive system of taxation.
- This system further lessens the administrative burden on taxpayers as a whole, as fewer entities (namely CLP providers, in this case Pick n Pay), would collect taxes and file forms for 8.5 million taxpayers. This proposed system removes the need for self-assessments and reduces the likelihood of non-compliance due to error or manipulation in the calculation of taxes.
- The proposed system improves tax compliance and reduces tax avoidance as seen in Section 2.6 when a WHT is implemented, and a near 99% tax compliance is reached (Thomas, 2019:90).
- Lastly, the implementation of the proposed system would increase the South African tax base and aid in lowering the South African budget deficit. It also addresses the

imbalance currently in place due to providers' receiving a deduction for CLP rewards but no tax being implemented on customers (refer to Section 3.3.2).

Therefore, the objective of quantifying the potential tax revenues forgone by the South African *fiscus* as a result of not taxing CLP rewards by customers of Smart Shopper has been met, as it was quantified to be R95 million over the period of 2018 to 2021.

4.3. LIMITATIONS OF THIS STUDY

This study is exposed to limitations, with the first being that it focuses solely on the Smart Shopper CLP in South Africa. Therefore, although the findings of this study may be indicative of the larger CLP landscape, the findings are limited to one CLP and are limited to South Africa. Therefore, the findings may prove of limited use for other CLPs and jurisdictions. Additionally, the findings of this study may not be generalisable to other CLPs in South Africa due to the differing terms and conditions between various CLPs (refer to Section 1.6.5).

Furthermore, this study is limited to the available disclosures made by Pick n Pay regarding the Smart Shopper CLP. During the course of this study the researcher was compelled to make certain assumptions and estimates due to limited disclosures, as the value of Smart Shopper points issued to customers was not separately disclosed. However, these estimates were based on reliably presented information in Pick n Pay's financial statements. In addition, these estimates were reviewed by an independent expert who confirmed the reasonableness of the estimates and calculations made.

In addition to the above, the response of CLP providers and customers to the introduction of the proposed tax has not been analysed. However, the proposal attempts to limit the negative response by alleviating administrative burdens on the parties (refer to Section 2.6).

4.4. FUTURE AREAS OF RESEARCH

Although the researcher believes that the proposed method of taxation provides a significantly higher benefit to the *fiscus* than the costs involved, additional research is required to address other tax implications that were not part of the scope of this study. The researcher identified that additional research is required regarding the administrative provisions necessary to ensure that the proposed method is able to be implemented. Furthermore, although the researcher believes that the proposed method would have a

limited impact on the behaviour of CLP customers and providers, additional research surrounding these changes in behaviour may be needed.

Moreover, throughout the research conducted in the greater study it was identified that there are significant differences between the disclosures of CLP rewards in the annual financial statements of different providers. Therefore, additional research is necessary in relation to the disclosure of CLP rewards for the purposes of users of financial statements in order for a more uniform approach to disclosure between different providers. In addition to the above, this and the greater study did not address unilateral changes in point balances, to whom points accrue when multiple cards are linked, as well as wholesale purchase of trading stock using CLP rewards.

4.5. CONCLUSION

The South African government is in dire need of additional sources of tax revenues (National Treasury, 2021a:10). The government has not kept up with recent increases in popularity of CLPs which has resulted in the current imbalance in the tax system due to CLP providers receiving a deduction for expenditure incurred on rewards granted, but no equivalent tax being levied on the customers receiving these rewards. This imbalance should be of concern for the South African government, as it increases the need for tax revenues. Therefore, the researcher suggested a method for taxation of CLP rewards earned by customers which will not impose a significant burden on SARS' current administrative capacity. The researcher has identified that significant tax revenues may be collected by the South African *fiscus* if the suggestion were to be implemented.

R95 million in tax revenues may be collected from the CLP rewards earned by Smart Shopper customers in aggregate for the financial years 2018 until 2021, if these rewards are taxed at a rate of 25%. This revenue is expected to be significantly larger as CLP rewards will ultimately be taxed at a customer's progressive tax rate and higher income earners use CLPs more rigorously. Furthermore, it is notable that this study is limited to that of just one CLP, namely the Smart Shopper, and it is expected that such tax revenues from one CLP may be an indicator of that of the rest of the population. Therefore, significant tax revenues may be gleaned from the taxation of other CLPs not included in the scope of this study.

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APPENDIX A

Table 18: Alternative calculation of points issued excluding expected forfeiture

Financial year	2018	2019	2020	2021
	R million			
Smart Shopper deferred revenue opening balance before expected forfeiture	163.4	139.3	117.5	149.0
Smart Shopper deferred revenue opening balance (refer to Table 6 and disclosed)	137.4	121.3	96.9	122.9
CLP rewards adjusted for expected forfeiture (refer row A of Table 13)	84.1%	87.1%	82.5%	82.5%
Less revenue recognised from CLP reward points before expected forfeiture	78.4	90.3	61.7	108.6
Less revenue recognised from CLP reward points (reward points redeemed or utilised and expired) (refer to Table 9)	67.1	76.6	50.9	91.0
CLP rewards adjusted for expected forfeiture (refer row C of Table 13)	85.6%	84.8%	82.5%	83.8%
Less Smart Shopper deferred revenue closing balance before expected forfeiture	139.3	117.5	149.0	200.7
Equals Smart Shopper deferred revenue closing balance (refer to Table 6 and disclosed)	121.3	96.9	122.9	170.6
CLP rewards adjusted for expected forfeiture (refer row B of Table 13)	87.1%	82.5%	82.5%	85%
Equals, points issued and expected to be utilised excluding expected forfeiture (balancing amount)	54.3	68.5	93.2	160.3

Source: Own design using calculations from financial statement data (Pick n Pay Stores Limited, 2018:45; Pick n Pay Stores Limited, 2019:43, 70; Pick n Pay Stores Limited, 2020:48, 78; Pick n Pay Stores Limited, 2021a:47, 78).

