



# **VALUE-ADDED TAX: A STORY OF CUSTOMER LOYALTY PROGRAMMES**

by

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## ABSTRACT

The South African tax system provides tax revenue to fund the expenditure incurred by the South African government. However, due to the severe harm caused by the COVID-19 pandemic, which disrupted and damaged economies worldwide, the South African government is more in need of additional sources of tax revenues than ever. Customer Loyalty Programmes (CLPs) in South Africa have increased in popularity and uptake, and consequently, it may be beneficial for the *fiscus* to consider increasing tax revenues by taxing rewards granted to customers who participate in CLPs.

Commentators have argued that the current value-added tax (VAT) system provides room for the taxation of CLP rewards granted to customers, however, differing opinions and limited legal guidance are available in this regard. This study, therefore, followed a qualitative, doctrinal research approach to ascertain, amongst others, the current main arguments in relevant literature regarding the VAT taxability of CLP rewards.

The findings of this study revealed that two main schools of thought regarding the VAT taxability of CLP rewards exist in current literature. This study aims to contribute a third school of thought to the VAT consequences arising from the granting of CLP rewards. The first school of thought supposes that a customer participating in a CLP will receive the CLP reward free of charge. In other words, the customer pays for the goods or services acquired from the CLP operator, and the CLP operator grants CLP rewards at no additional cost to the customer. The second school of thought, however, contends that the customer participating in a CLP is, in fact, paying for the CLP reward in money. This school of thought, which is drawn from the accounting treatment of CLP rewards granted, regards the amount paid by the customer to the CLP operator for the goods and/or services purchased as comprising a part-payment for the goods and/or services purchased, and a part-payment for the CLP rewards granted. The third and final school of thought as proposed by this study suggests that the customer provides a consideration for CLP rewards, in the form of customer information. This proposed school of thought is an original contribution made by the present study and is supported by the objectives of a CLP outlined by researchers, and the terms and conditions of the three most-used CLPs of 2021 in South Africa. The result of consideration being given for the granting of CLP rewards is that output tax will have to be raised by the CLP operator on the supply of these CLP rewards and the burden of this output

tax will be carried by the CLP operators themselves. This study found that the predominant argument held by commentators aligns with the first school of thought, which is that CLP members receive CLP rewards free of charge. Consequently, if this school of thought is followed, the granting of CLP rewards will not attract VAT.

**Keywords:** Consideration, coupon, customer loyalty programme rewards, donation, gift certificate, loyalty points, monetary value, money, South Africa, 'token, voucher or stamp', value-added tax (VAT).

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## **Background:**

The South African tax system funds expenditure incurred by the South African government. However, the South African government is in dire need of additional sources of tax revenues more than ever, due to the disruption and damage caused by the COVID-19 pandemic to economies worldwide. Customer Loyalty Programmes (CLPs) have increased in popularity and uptake around the globe as well as in South Africa. Consequently, it may be beneficial for the *fiscus* to consider taxing rewards granted under CLPs to increase tax revenues. Commentators have argued that the current South African value-added tax (VAT) system makes provision for the taxing of CLP rewards granted to CLP members, however, there are differing opinions and a lack of legal guidance in this regard.

## **Main purpose of study:**

The aim of this study is to predominantly identify and analyse the main arguments in current literature surrounding the South African VAT consequences from the granting of CLP rewards.

## **Method:**

This study followed a qualitative, doctrinal research methodology that is also reform-oriented. This allowed for a critical analysis of relevant legislation and case law, along with research by other contributors.

## **Results:**

The findings of this study revealed three main schools of thought regarding the South African VAT consequences from the granting of CLP rewards. The first school of thought supposes

that a customer participating in a CLP receives CLP rewards free of charge. The second school of thought suggests the consideration paid by the CLP member for the underlying goods and services acquired must be allocated to both the goods and services acquired and CLP rewards granted. Consequently, this school of thought supposes the CLP member pays consideration in money for CLP rewards granted. The third school of thought argues that CLP rewards are supplied to CLP members for a consideration in the form of customer information. This school of thought is an original contribution made by the present study and is supported by the objectives of a CLP as outlined by researchers, and the terms and conditions of the three most-used CLPs of 2021 in South Africa. The result of consideration being given for the granting of CLP rewards is that output tax will have to be raised by the CLP operator on the supply of these CLP rewards and the burden of this output tax will be carried by the CLP operators themselves. However, if it is argued that CLP rewards are indeed granted for free, no output tax must be raised on the supply of CLP rewards to CLP members.

### **Conclusions:**

Uncertainty regarding the VAT treatment of the granting of CLP rewards remains. However, despite this uncertainty, this study found that commentators are inclined towards the first school of thought, namely that CLP rewards are granted to CLP members free of charge. Resultantly, if this school of thought is followed, no VAT should be raised on the granting of CLP rewards.

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## LIST OF ABBREVIATIONS AND ACRONYMS

Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
Australian GST Act	A New Tax System (Goods and Services Tax) Act, No. 55 of 1999
Canadian Excise Tax Act	Excise Tax Act, R.S.C. 1985, c. E-15
CIBC	Canadian Imperial Bank of Canada
CLPs	Customer Loyalty Programmes
CPA	Consumer Protection Act, No. 68 of 2008
GDP	Gross Domestic Product
GST	Goods and Services Tax
IFRIC 13	International Financial Reporting Interpretations Committee 13
IFRS	International Financial Reporting Standard
Income Tax Act	Income Tax Act, No. 58 of 1962
LPO	Loyalty programme operator
SA	South African
SARS	South African Revenue Service
VAT	Value-Added Tax
VAT Act	Value-Added Tax Act, No. 89 of 1991

## **CHAPTER 1: INTRODUCTION**

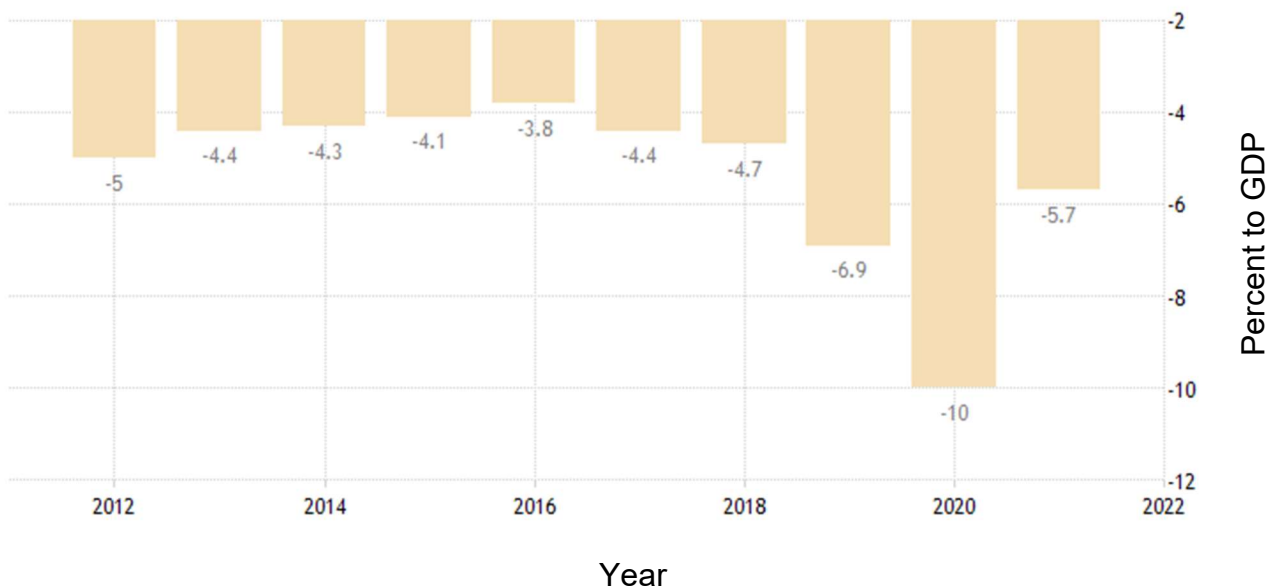
### **1.1. INTRODUCTION**

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 can be either financial or non-financial rewards (Breugelmans *et al.*, 2015:129). Businesses also use CLPs as a mechanism to track and influence customer decisions (Breugelmans *et al.*, 2015:128). In addition to the rewards which they receive, customers utilise CLPs as it enhances and personalises their experiences, saves time, and provides flexible and accessible purchasing and reward options (Burnstone & Olivier, 2018:4). As a result of the benefits for both businesses and customers, CLPs have become prevalent across a broad range of industries around 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 businesses and customers in South Africa. 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 globally (National Treasury, 2021a:3).

According to the South African Revenue Service (SARS), the actual net collections represented a contraction of 7.8% in the 2020/21 fiscal year in comparison to the 2019/20 fiscal year and the projected 2020/21 tax collection shortfall was expected to be the largest on record (National Treasury, 2021b:3). The upsurge in government spending is expected to increase globally in the short term and the focus on tax revenues is becoming inherently 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 fiscal year (National Treasury, 2021b:9). The real Gross Domestic Product (GDP) growth 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.

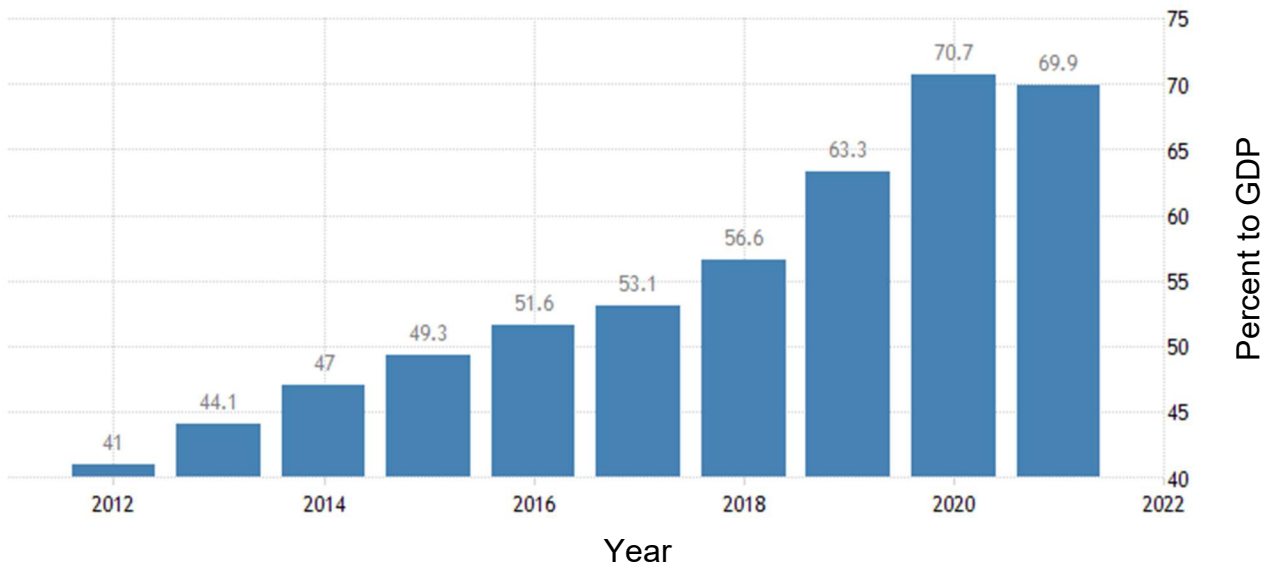
**Figure 1: Government budget deficit**



Source: Trading Economics (2022a)

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

**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 as well as the contractions in tax collections over the past years, the *fiscus* is in need of additional revenue collections by expanding the tax base (National Treasury, 2021b:3). An increase in tax of up to R40 billion in total would be needed to help stabilise public debt and return public finances to a sustainable portion over the four years following 2020 in order for the economy to start running smoothly again (National Treasury, 2021b:3). Further, 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 suggests a maximum ratio 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 differing opinions and limited guidance on the tax treatment of CLP rewards in a South African value-added tax (VAT) context. In brief, the Value-Added Tax Act, No. 89 of 1991 (the VAT Act), which is South Africa's taxing legislation focused on taxing consumption within South Africa, provides for the taxation of the supply by a vendor of goods or services supplied by the

vendor in the course or furtherance of any enterprise. In November 2021, SARS issued Interpretation Note 118 which provides SARS's interpretation of the VAT consequences of points-based CLP rewards (SARS, 2021b:1). It is important to note that Interpretation Notes issued by SARS, albeit useful, do not constitute law and is merely SARS's interpretation of tax legislation. Furthermore, to date, there have been no South African court cases addressing the taxability of CLP rewards received by a customer, whether in a normal tax or VAT context. As mentioned below, there have been court cases addressing the tax treatment of CLP rewards in the hands of suppliers in South Africa, however, only from a normal tax deduction perspective.

In the context of CLPs and the taxation thereof, two recent cases were considered by the judiciary in *Big G Restaurants (Pty) Limited v Commissioner for the South African Revenue Service*, 2020 (6) SA 1 (CC) and *Clicks Retailers (Pty) Limited v Commissioner for the South African Revenue Service*, 2021 (4) SA 390 (CC). The aforementioned two cases are kindred not only because they are two of the few tax cases to appear before the Constitutional Court of South Africa, but also because they are two of the first cases to address the taxation of CLPs. While the taxpayers in these cases failed in their attempts to claim a deduction for future expenditure to be incurred in relation to their CLPs under section 24C of the Income Tax Act, No. 58 of 1962 (the Income Tax Act), 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 Income Tax Act (Brink, 2014; Pidduck & Odendaal, 2013:1526). Nevertheless, the corresponding rewards received by customers are not taxed and indicates 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 meet the requirements of the charging section contained in the VAT Act and consequently, fall within the South African VAT framework (Geerlings, 2021:37; SARS, 2021b). However, these commentators disagree, with merit, on the VAT consequences of CLP rewards. It is argued that points-based CLP rewards received by customers are a 'voucher' and the VAT treatment thereof is aligned with the treatment of a 'token, voucher or stamp' as envisaged in section 10(18) of the VAT Act (SARS, 2021b:8). Section 10(18) of the VAT Act requires

vendors to disregard the initial supply of CLP rewards. These rewards are then treated as payment or part-payment in the form of consideration only upon redemption by the customer of the CLP rewards when the customer makes a further purchase. It is furthermore important to note that, even though Interpretation Note 118 is valuable, it is seemingly flawed in certain respects. Van Schalkwyk (2021:4) notes that Interpretation Note 118 stipulates that no deduction is available to a redemption partner where they are reimbursed by the loyalty programme operator for an amount less than the value of the points redeemed. Consequently, the redemption partner pays VAT on a higher amount than the consideration they received for the supply, which is in contravention of the operation of the VAT system (Van Schalkwyk, 2021:4). Geerlings (2021:22), on the other hand, argues that output tax must be levied on the initial supply of CLP rewards to customers, and not only upon redemption. Consequently, there is no consensus or clear legal guidance to rely on regarding the taxability of CLP rewards from a South African VAT perspective.

## **1.2. RATIONALE FOR THE STUDY**

Due to the lack of consensus or clear legal guidance, it is necessary to consider the VAT consequences of CLP rewards. This study aims to determine whether CLP rewards are taxable within the South African VAT framework, and if so, in what manner.

Prior to 2018, the deferred revenue presented in the annual financial statements of the providers that offer CLPs was presented based on the International Financial Reporting Standards (IFRS), 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 and 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 on 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 by entities, a need arose for the International Accounting Standard Board 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 replaced by IFRS

15 (Deloitte Touche Tohmatsu Limited, 2016:2-3). IFRS 15 requires companies to implement a five-step approach to recognise, measure, and present revenue and deferred revenue received from a customer (Dili, 2017:1; International Accounting Standards Board, 2018:870).

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

### **1.3. RESEARCH PROBLEM**

Substantial growth has been experienced in CLPs in South Africa over the past decade and are used by over 74% of South Africans who are economically active (Cromhout, 2021:5). Despite the considerable increase in participation in CLPs in South Africa, there is a lack of clear or specific guidance on the VAT consequences of granting CLP rewards to customers as a result of being members of CLPs. The problem is compounded by the lack of consensus in current literature regarding the VAT treatment of CLP rewards. Therefore, this study aims to critically evaluate the main arguments contained in current literature regarding the VAT treatment of CLP rewards granted to members of CLPs, consider international literature addressing comparative tax treatment of CLP rewards, and contribute to South African literature regarding the VAT consequences of granting CLP rewards to customers.

### **1.4. RESEARCH QUESTION**

The following research questions were formulated to guide the undertaking of this study:

- What are the main arguments addressed in current literature regarding the VAT treatment of CLP rewards in South Africa?
- What arguments in international literature are currently available to provide guidance in respect of the VAT treatment of CLP rewards in South Africa?

## **1.5. RESEARCH OBJECTIVES**

This study has the following research objectives:

- Define the characteristics of a CLP for the purposes of this study that would result in rewards potentially being subject to tax under the South African VAT system.
- Critically review the main arguments addressed in current literature regarding the VAT treatment of CLP rewards in South Africa.
- Consider current international literature relating to the taxability of CLP rewards in terms of taxes in other jurisdictions that are comparable to the South African VAT system.

## **1.6. RESEARCH DESIGN AND METHODOLOGY**

This study will follow a qualitative, doctrinal research methodology. Qualitative research can be defined as a naturalistic inquiry dealing with non-numerical data, which aims to explore and understand as opposed to manipulating variables (Nassaji, 2020:427). Qualitative research can also be described as an iterative process whereby an improved understanding is achieved by making new meaningful distinctions as a result of getting acquainted with the subject matter researched (Aspers & Corte, 2019:155). Nassaji (2020:427) further describes qualitative research as interpretive and systematic, involving a process of identifying the problem, collecting, analysing, explaining, evaluating, and interpreting data. It is important to note that qualitative research does not seek a conclusive answer about the magnitude of the subject matter, instead, it aims to understand and explain by making interpretations about a process, as opposed to its outcomes (McKerchar, 2008:17). Consequently, a qualitative research methodology is appropriate for the purposes of this study, as this study aims to gain an understanding of the South African VAT consequences arising from the granting of CLP rewards to customers, by gathering, analysing, and interpreting relevant literature and limited case law. This study, therefore, employs a qualitative doctrinal research methodology which is reform-oriented. Doctrinal and reform-oriented research are discussed below.

### **1.6.1. Doctrinal research**

Smits (2017:210) defines doctrinal research as, “research that aims to give a systematic exposition of the principles, rules and concepts governing a particular legal field or institution and analyses the relationship between these principles, rules and concepts with a view to solving unclarities and gaps in the existing law”. Doctrinal research involves a critical

conceptual analysis of all relevant legislation and case law which aims to divulge a statement of the law (Hutchinson, 2014:584). Ergo, this form of research contains a deep analysis of legal principles and is thus research into the law and legal concepts (Al Amaren, Hamad, Al Mashhour & Al Mashni, 2020:54; Hutchinson & Duncan, 2012:85).

Pidduck (2019:210) states that doctrinal research requires the researcher to analyse a vast range of literature with an aim of understanding the interpretation and application of relevant doctrines and statutes. Furthermore, it is paramount to consider literature that both supports and conflicts with the interpretation and application of the doctrines, as this instils confidence in the findings and requires deeper insight (Pidduck, 2019:210). It thus enables the study to identify themes across the relevant literature and garner fruitful meaning and interpretation of the statutes (Pidduck, 2019:210). Doctrinal research is consequently fitting for this study, as this study will consider a broad range of literature, both supporting and conflicting, in order to obtain an understanding of the interpretation and application of the South African VAT system with regards to the granting of CLP rewards to customers.

### **1.6.2. Reform-oriented research**

Reform-oriented research, as described by Hutchinson (2014:585) and Hutchinson and Duncan (2012:101), based on the definition by the Pearce Committee (Pearce, Campbell & Harding (1987)), can be defined as research which intensively evaluates the appropriateness of existing rules and recommends changes to any rules that are amiss. This form of research is appropriate when the research is aimed at proposing amendments to existing legislation which has not yet been scrutinised by the courts (Pidduck, 2019:208). Coetsee and Buys (2018:76) note that reform-oriented research probes the appropriateness of underlying doctrines developed in the relevant field under question. Evidently, a reform-oriented approach is suited for this study, as this study will evaluate the appropriateness of existing VAT legislation with regards to the granting of CLP rewards to customers. However, the present study will not make specific proposals for legislative amendments, but will merely analyse current literature, including existing legislation and will identify the main arguments or schools of thought regarding the VAT consequences from the granting of CLP rewards. This will be done with the aim of investigating the appropriateness of existing legislation and the main arguments present in this regard.

## **1.7. SCOPE LIMITATION**

This study will focus on the South African VAT consequences arising from the granting of CLP rewards to customers under points-based CLPs by considering relevant literature and possible international guidance drawn from Canada and Australia. Furthermore, this study will only address the most simplistic form of CLP, namely an exclusive programme, which is a CLP that is administered by the CLP operator (SARS, 2021b:7). In an exclusive programme, only two parties are present, namely the CLP member and the CLP operator, who fulfil the roles of loyalty partner, redemption partner and CLP operator (SARS, 2021b:7). A 'CLP operator' refers to the business that manages and controls the CLP, whereas a 'CLP member' is the customer who is a participant of the CLP. A 'loyalty partner' is the business at which the CLP member can earn CLP rewards, whereas a 'redemption partner' is the business at which the CLP member may redeem CLP rewards accrued to them (SARS, 2021b:2). The structure of the mini-dissertation is discussed below.

## **1.8. STRUCTURE OF THE MINI-DISSERTATION**

The structure of this study will be as follows:

### **Chapter 1: Introduction**

Chapter 1 provides an introduction and broad background of the research topic. This chapter also provides the rationale for the study, elaborates on the research methodology followed, and provides a description of the research problem, research questions, and research objectives. Lastly, Chapter 1 provides the scope limitation as well as the structure of the mini-dissertation.

### **Chapter 2: Literature review**

A rigorous literature review is undertaken in Chapter 2. This chapter includes a description and transactional flow of CLPs and defines a CLP for the purposes of this study. Furthermore, Chapter 2 provides the objectives of a CLP, along with a brief analysis of implied objectives of the top three most-used CLPs of 2021 in South Africa. Lastly, this chapter discusses the accounting treatment related to CLPs, as guidance may be extracted from accounting standards in determining the South African VAT treatment of the granting of CLP rewards.

### **Chapter 3: Value-Added Tax on CLP rewards in South Africa and relevant guidance from other jurisdictions**

Chapter 3 addresses the legislative provisions relevant to CLP rewards and considers guidance from Canada and Australia with regards to the VAT taxability of the granting of CLP rewards in South Africa.

### **Chapter 4: Conclusion**

This chapter concludes the study by providing a summary of the research findings. Chapter 4 also includes suggestions for future research.

## **CHAPTER 2: LITERATURE REVIEW**

### **2.1. INTRODUCTION**

This chapter will provide a background to CLPs, with the aim of gaining an understanding of CLPs and the typical operation thereof, especially in a South African context. Furthermore, this chapter will consider and decide on a definition of a CLP for the purposes of this study, by considering definitions laid out by prior researchers such as Breugelmans *et al.* (2015); Brink (2014); and Burnstone and Olivier (2018), amongst others. This chapter will also consider the definition and operation of CLPs as laid out in other relevant literature such as the Consumer Protection Act, No. 68 of 2008 (CPA) and SARS Interpretation Note 118. Lastly, this chapter will discuss the international accounting treatment of CLP rewards, since guidance may be drawn from the accounting sphere when determining the VAT consequences from granting CLP rewards.

It is important to note, however, that this chapter omitted certain literature such as the specific legislative provisions of the VAT Act, since these provisions and literature will be addressed in-depth in Chapter 3.

### **2.2. UNDERSTANDING CLPS**

Before exploring the possible VAT consequences arising from the granting of CLP rewards to customers, it is important to define a CLP for the purposes of this study as well as gain an understanding of how, and under which objectives, CLPs operate.

#### **2.2.1. CLPs defined**

CLPs are reward systems that provide rewards to customers to incentivise them to remain loyal to the business providing the CLP (Breugelmans *et al.*, 2015:128; Pidduck *et al.*, 2019:626; Swanepoel & Pidduck, 2020:76). These rewards can be either financial or non-financial rewards (Breugelmans *et al.*, 2015:129). Businesses also use CLPs since it allows them to track and influence customer decisions (Breugelmans *et al.*, 2015:128). In addition to the rewards received, customers utilise CLPs because it enhances and personalises their experiences, saves time, and provides flexible and accessible purchasing and reward options (Burnstone & Olivier, 2018:4).

Brink (2014) confirms that CLPs are available to the public and allow customers to accumulate benefits after making a purchase. Customers may thereafter decide to use these accumulated benefits to either receive goods or services or to receive a discount on any future purchase of goods or services (Brink, 2014). Olivier and Burnstone (2014:3) classify CLPs into two main categories being “Rewards Programmes” and “Customer Clubs”:

- Rewards programmes are structured marketing strategies that encourage specific consumer behaviour and reward customers in the process (Olivier & Burnstone, 2014:3). Customers are rewarded in a variety of ways, those being a discount on a current transaction, an allocation of loyalty points that can be redeemed on a future transaction, access to products or services not normally sold, or access to certain membership privileges not available to non-members, for example, access to airport lounges or preferential queues (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 discounts, value-added benefits, and/or peace of mind benefits (Olivier & Burnstone, 2014:3).

Notwithstanding these categories and descriptions, Chun, Iancu and Trichakis (2020:1) believe that CLP rewards are seen as a form of currency, which customers use to transact with firms. Liu and Yang (2009:94) define CLPs as: “long-term-oriented programs that allows customers to accumulate some form of program currency, which can be redeemed later for free rewards”. These definitions imply that CLP rewards are a form of currency. The notion of CLP rewards being a currency will be further explored by considering the CPA.

The CPA defines a ‘loyalty programme’ in section 1 as:

“any arrangement or scheme in the ordinary course of business, in terms of which a supplier of goods or services, association of such suppliers, or other person on behalf of or in association with any such suppliers, offers or grants to a consumer any loyalty credit or award in connection with a transaction or an agreement” (South Africa, 2008).

Furthermore, section 1 of the CPA defines a ‘loyalty credit or award’ as:

- “(a) any benefit accruing to the consumer,
- (b) right to any goods, service or other benefit granted to a consumer or

(c) point, credit, token, device or other tangible or intangible thing which, when accumulated in sufficient quantities, entitles the holder to seek, request or assert a claim for any goods, service, or other benefit, allocated to the consumer, in terms of a loyalty programme, irrespective of the name, nature, form or characterisation assigned by that loyalty programme to any such goods, service or other benefit, right or thing” (South Africa, 2008).

The necessity of these definitions in the CPA is because the CPA, as laid out in section 3 of this act, is intended to “promote and advance social and economic welfare of consumers in South Africa” (South Africa, 2008). This purpose is achieved, with regards to CLPs, through section 35 of the CPA, in which loyalty credits or awards, for the purposes of the CPA, are deemed to be a legal medium of exchange when those credits or awards are redeemed as consideration for goods or services in terms of that loyalty programme. It is important to note that section 35 of the CPA does not deem loyalty credits or awards as legal medium of exchange or legal tender in general at any person or business offering goods or services (South Africa, 2008). Instead, by virtue of the wording “for all purposes of this Act” and “legal medium of exchange ... in terms of that loyalty programme” (own emphasis) in section 35(1) of the CPA, CLP rewards are clearly only redeemable and therefore deemed a legal medium of exchange at redemption partners participating in the loyalty programme (South Africa, 2008).

This is further supported by the South African Reserve Bank Act, No. 90 of 1989, which, in section 17, provides that only banknotes and coins (the rand) issued by the South African Reserve Bank are legal tender in South Africa, eSwatini, Lesotho, and Namibia (South African Reserve Bank, 2020). It is important to define legal tender in South Africa, as this definition will be important when considering the VAT taxability of CLP rewards, especially in the context of ‘money’ as defined in the VAT Act.

The definition of ‘money’ in section 1(1) of the VAT Act reads:

“(a) coins (other than coins made wholly or mainly from a precious metal other than silver) which the South African Reserve Bank has issued in the Republic in accordance with the provisions of section 14 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), or which remain in circulation as contemplated in the proviso to subsection (1) of that section, and any paper currency which under the said Act is a legal tender;

(b) (i) any coin (other than a coin made wholly or mainly from a precious metal) or paper currency of any country other than the Republic which is used or circulated or is intended for use or circulation as currency;

(ii) any bill of exchange, promissory note, bank draft, postal order or money order, except when disposed of or imported as a collector's piece, investment article or item of numismatic interest" (South Africa, 1991).

(Own emphasis)

Money thus excludes coins made wholly or mainly from a precious metal such as gold or platinum (Stiglingh, 2021:1074). For example, Kruger Rands are made from gold and are therefore not included in the definition of 'money' in section 1(1) of the VAT Act. Furthermore, from this definition, it is clear that CLP rewards (specifically, loyalty points) are not 'money' as defined in the VAT Act, as these loyalty points are not coins or paper currency issued by the South African Reserve Bank, coins or paper currency intended as currency of another country, nor a bill of exchange, promissory note, bank draft, or postal or money order. It is therefore necessary to continue the exploration of the CPA to determine the meaning and commercial substance of loyalty points.

Trade coupons and similar promotions are addressed in section 34 of the CPA. These terms are not defined, however, section 34(2) of the CPA defines a 'promotional offer', which is presumed, by virtue of the words 'trade coupons and similar promotions' being included in the title of section 34, to include trade coupons, as:

"an offer or promise, expressed in any manner, of any prize, reward, gift, free good or service, price reduction or concession, enhancement of quantity or quality of goods or services, irrespective of whether or not acceptance of the offer is conditional on the offeree entering into any transaction" (South Africa, 2008).

Section 34 furthermore, lays out in a summary that the offeror of such a 'promotional offer' should not mislead the consumer, and should be able to fulfil the promise to provide the goods or services as promised (South Africa, 2008). Section 34 (trade coupons and similar promotions) differs from section 35 (CLPs, as previously addressed), in that a 'promotional offer' (or trade coupon) is not regarded as a legal medium of exchange for goods or services provided by the offeror, whereas loyalty credits or awards granted under loyalty programmes are considered a legal medium of exchange in terms of the loyalty programme which granted it. Furthermore, the definition and treatment of promotional offers or trade coupons are

relevant for the purposes of this study as it will be considered against 'token, voucher or stamp' as addressed in sections 10(18) to 10(20) of the VAT Act.

A CLP is not defined in the VAT Act, thus the definition from the CPA can further be elaborated on with reference to SARS Interpretation Note 118. Interpretation Note 118 (2021b:2) defines a 'loyalty programme' as a programme or scheme under which member rewards are quantified using loyalty points (a points-based loyalty programme), with the following characteristics (2021b:4):

- Loyalty programme membership must be open to any customer of an entity or group, or the public as a whole.
- Loyalty points are allocated to members as a result of their membership to the loyalty programme and the reward is quantified based on, amongst others, the value of goods or services acquired from certain entities, promotion of specific customer behaviour or merely by virtue of membership.
- No additional payment or consideration is required to entitle the member to the loyalty points, except for a membership fee, where applicable.
- Members of the loyalty programme may in some cases be entitled to pay less for certain goods or services, however, at no point have to pay more or an additional amount which can be construed as being consideration for the allocation of loyalty points.
- Loyalty points must have a value attached to it, whether specific or notional.
- Loyalty points can be redeemed and used as payment by members for goods or services with a value similar or equal to the fair value of the loyalty points.

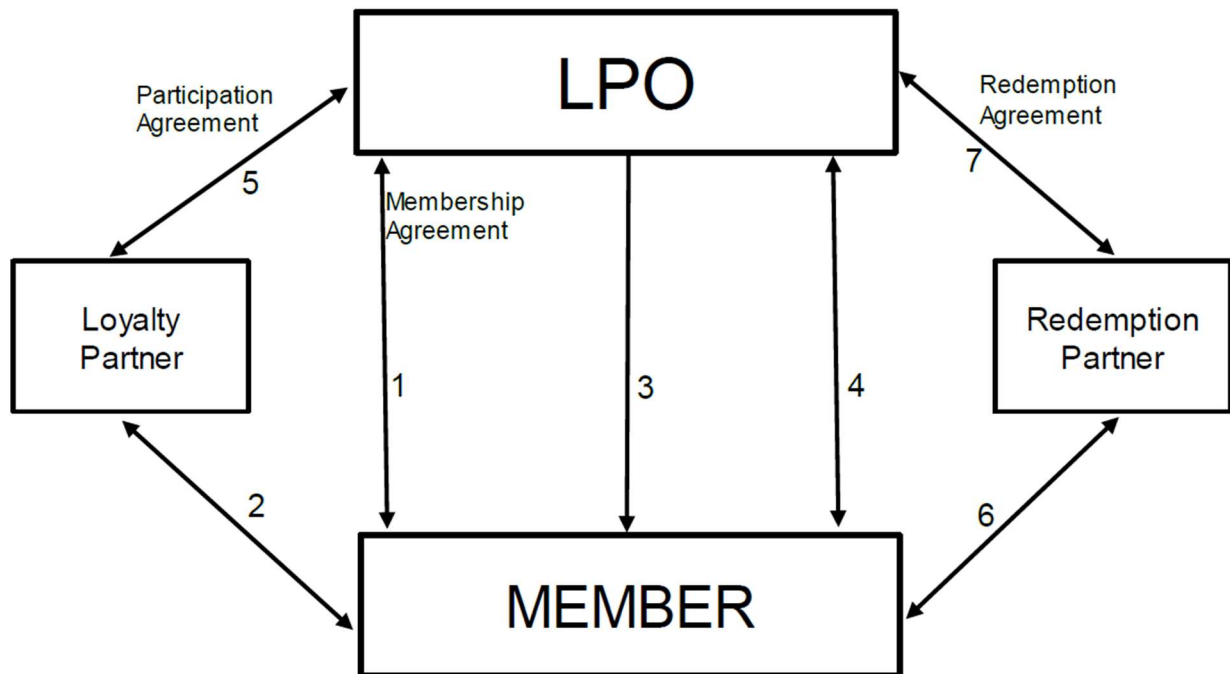
As in Interpretation Note No. 118, the focus of this study is on points-based CLPs and the VAT taxability thereof in South Africa (SARS, 2021b:3). However, it must be noted that although members of a CLP may in some instances be entitled to pay less for certain goods or services, this is not a pre-requisite for the definition of a CLP both for the purposes of this study and as defined by SARS in Interpretation Note 118 (SARS, 2021b:4). An upfront discount is specifically excluded from the definition of a CLP for this study. Instead, this study and SARS Interpretation Note 118 focus only on points-based CLPs.

### **2.2.2. Typical operation and transactional flow of CLPs**

As the meaning of a CLP has been established, it is now necessary to consider the operation of a CLP and to determine the parties to a CLP. Figure 3 below, containing a diagram of the

parties to, and the transactions contained in a CLP, illustrates the transactional flow and operation of CLPs.

**Figure 3: Transactional flow of CLPs**



Source: SARS (2021b:5)

Although the operation of a CLP can become quite complex, the focus of this study is only on transactions 2 and 3 from Figure 3, which is explained below. Furthermore, the diagram uses certain terminology to illustrate the operation of a CLP, which is also described below.

The terminology used in Figure 3 can be explained as follows. A ‘LPO’ refers to the loyalty programme operator, which is the company that manages and controls the CLP. A ‘member’ is the customer who is a participant of the CLP. The ‘loyalty partner’ is the company at which CLP rewards are earned, which usually includes the LPO, and in some CLPs, other partnering businesses. A ‘redemption partner’ is the company at which the member may redeem CLP rewards, and as with the loyalty partner, this usually includes the LPO and, in some CLPs, other partnering businesses. The terminology used in Figure 3 will now be used in considering transactions 1, 2, 3, and 6, in order to gain an understanding of the operation of a CLP. Transaction 4 addresses the sale of a loyalty point by the CLP operator to the CLP member, whereas transactions 5 and 7 deal with the participation agreement and

redemption agreement between the CLP operator and loyalty and redemption partners respectively, none of which are relevant to this study.

Considering transaction 1 as illustrated in Figure 3, a customer enters into a membership agreement with the company operating the CLP. This is illustrated in transaction 1 and can be explained as the customer obtaining, for example, a loyalty card from the LPO which will allow the customer to participate in the CLP. Transaction 2 illustrates the customer making eligible purchases, amongst others, at the loyalty partner. Lastly, transaction 3 represents the granting of CLP points by the LPO to the member, as a consequence of transaction 2, amongst others. This study will focus on the scenario where only two parties are involved, which can also be referred to as an 'exclusive programme', whereby the CLP is administered in-house with the supplier of goods or services acting in the role of LPO, loyalty partner and redemption partner (SARS, 2021b:7). To demonstrate the various participants of, and transactions arising from a CLP, the most-used CLP of 2021 according to Cromhout (2021:15), namely Pick n Pay Smart Shopper, will be used in a practical example, see Example 1 below.

**Example 1: Practical example using Pick n Pay Smart Shopper to demonstrate the operation of CLPs as illustrated in Figure 3**

Pick n Pay Stores Limited (Pick n Pay) is the loyalty programme operator (LPO) of the CLP Pick n Pay Smart Shopper (PnP Smart Shopper) in which CLP points, called 'Smart Shopper Points', are granted to customers who participate in PnP Smart Shopper. Pick n Pay grants members a 'Smart Shopper Card' which can be illustrated in transaction 1 in Figure 3. Pick n Pay itself is also a loyalty partner, as illustrated in transaction 2 in Figure 3, since members of PnP Smart Shopper can earn points from purchases made at Pick n Pay when swiping their Smart Shopper Cards on purchase. Members of PnP Smart Shopper can also earn points from fuel purchases made at BP Southern Africa (Pty) Ltd (BP) (Pick n Pay Stores Limited, 2022a). This makes BP a loyalty partner of PnP Smart Shopper and also represents transaction 2 in Figure 3. When a member of PnP Smart Shopper makes a qualifying purchase at a loyalty partner and swipes their Smart Shopper Card, Pick n Pay, as LPO, grants the member Smart Shopper Points, as illustrated in transaction 3 of Figure 3.

Furthermore, Pick n Pay itself is also a redemption partner, as depicted in transaction 6 of Figure 3, as members of PnP Smart Shopper can redeem their Smart Shopper points at Pick n Pay. However, members can also redeem their Smart Shopper points at other companies, such as

Ster-Kinekor Theatres (Pty) Ltd (Ster-Kinekor), whereby members can convert a certain number of their Smart Shopper points to a 2D movie ticket which can be used at Ster-Kinekor (Pick n Pay Stores Limited, 2022e). Consequently, Ster-Kinekor is a redemption partner of PnP Smart Shopper. This represents transaction 6, which falls outside the scope of this study, but is referred to in order to provide clarity in the operation of a CLP.

As previously stated, the focus of this study is on the most simplistic form of a CLP, which can also be described as an 'exclusive programme', whereby the CLP is administered in-house with the supplier of goods or services acting in the role of LPO, loyalty partner and redemption partner (SARS, 2021b:7). Based on the example using Pick n Pay, an 'exclusive programme' will include only Pick n Pay as LPO, loyalty partner and redemption partner, and the customer as the member of PnP Smart Shopper. Furthermore, this study focuses on the granting of CLP rewards to customers and not on the redemption thereof. Consequently, only transactions 2 and 3 illustrated in Figure 3 are within the scope of this study.

### **2.2.3. Objectives of a CLP**

The meaning and operation of a CLP has been established under sections 2.2.1 and 2.2.2 respectively. However, it is also necessary to consider the objectives of a CLP, in order to establish the legal rights and duties arising therefrom.

O'Malley (1998:51) suggests a CLP is established for a variety of reasons, the most stated reason being to reward customers for certain behaviour such as repeatedly purchasing from the business offering the CLP. O'Malley (1998:51) furthermore notes that other objectives include gathering information on customers to improve targeting, manipulate customer behaviour by, for example, influencing customers to purchase certain or more of goods and services, and as a defensive mechanism to combat competition. Sharma and Verma (2014:924) state that CLPs attempt to cultivate customer loyalty by influencing customer behaviour and in doing so, compensate customers for their purchasing behaviour. Nsakanda, Diaby and Cao (2010:707) postulate that CLPs are aimed at rewarding customers for repeat purchasing of goods or services. In its most simplistic form, CLPs are designed to provide a benefit to the customer for executing some transaction with a certain company (Sharma & Verma, 2014:925). Lastly, Corbishley (2017:47) believes CLP rewards are granted to customers as a way to thank the customer for their support of the company,

and customers can return the sentiment by purchasing more from the company in question, which creates a self-perpetual cycle. What can be drawn from the aforementioned studies, is the fact that the CLP operator is making a supply of CLP rewards to its customers. Although customers generally do not pay (in money) to be granted CLP rewards, CLP rewards are granted in exchange for the customer's behaviour of repeatedly purchasing from the company (loyalty) and providing the company with their information and purchasing habits.

#### 2.2.3.1. *Quid pro quo versus donation*

Consequently, it can be argued that the customer provides the business with loyalty and information as a *quid pro quo* or consideration for CLP rewards to them. It is important to note, in this regard, that it is not the customer who supplies their information in exchange for a consideration in the form of CLP rewards, instead, it is the CLP rewards that are granted as a supply to the customer in exchange for consideration in the form of customer information. From a VAT perspective, it is critical that the supply of the CLP rewards be made for a consideration for the supply to attract VAT in the hands of the CLP operator. However, it is not necessary for the consideration to be in the form of money, as was found in *South Atlantic Jazz Festival (Pty) Ltd v Commissioner for the South African Revenue Service*, 2016 (6) SA 78, where South Atlantic Jazz Festival (Pty) Ltd, the appellant, provided branding and marketing services to sponsors who in turn, paid money and provided goods and services for an international jazz festival hosted by the appellant. The appellant was required to raise output tax on the branding and marketing services supplied to the sponsors. The inclusion of a barter transaction in the scope of the VAT Act is also evidenced in the definition of 'consideration' in section 1(1) of the VAT Act, which includes "any payment ... whether in money or otherwise ..." (South Africa, 1991).

The implication of the aforementioned barter transaction, in particular the supply of CLP rewards for a consideration in the form of customer information, is that the CLP operator will have to raise output tax when the CLP rewards are granted to the CLP member. The CLP operator will carry the burden of this output tax as the final consumer, since the transaction between the CLP operator and member is a barter transaction. The nature of barter transactions is inherently complex and consequently, the intricacies of this transaction is outside the scope of this study.

However, the alternative may be argued, in that customers do not pay (in money or otherwise) for CLP rewards. This belief, by nature, would suppose that CLP rewards are granted by businesses by 'sheer liberality' or 'disinterested benevolence', in other words, as a donation. A 'donation' is defined in section 1(1) of the VAT Act, however, it only addresses a donation made to an association not for gain, and does not address donations to other persons (SARS, 2021a:17). Consequently, the definition of a 'donation' must be considered by referring to common law. A 'donation' was defined in *Avis v Verseput*, 1943 AD 331 as "a gratuitous disposal of property prompted by motives of sheer liberality or disinterested benevolence". This definition was further considered in *Commissioner for Inland Revenue v Estate Late DJL Hulett*, 1990 (2) SA 786 (SCA) and *Estate RF Welch v Commissioner for the South African Revenue Service*, 2004 (2) SA 586 (SCA).

In *Commissioner for Inland Revenue v Estate Late DJL Hulett*, the Supreme Court of South Africa (Appellate Division) held that the definition of donation as aforesaid, pertains to the Income Tax Act and cannot be applied to a different Act where it was not defined. However, in *Estate RF Welch v Commissioner for the South African Revenue Service*, the Supreme Court of Appeal noted that the definition of the Income Tax Act includes an essential element of a donation as contained in common law, that being that the disposition must be "motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a *quid pro quo* of some kind from whatever source it may come". This common law definition of a donation can be attributed to the belief that businesses grant CLP rewards as a way of thanking the customer, as suggested by Corbishley (2017:47), with no expectation of a *quid pro quo*. However, as noted by Nsakanda *et al.* (2010); O'Malley (1998); and Sharma and Verma (2014), CLPs operate with the objectives, amongst others, of gathering information of customers and to reward customers for repeat purchasing behaviour. It is therefore clear that the granting of CLP rewards to customers is indeed not made by 'sheer liberality' or 'disinterested benevolence', since businesses are motivated by self-interest in the form of the collection of customer information and their intention to influence customer behaviour, amongst others. Consequently, the granting of CLP rewards does not constitute a donation as defined by common law. The question then still begs: Are CLP rewards then granted for a consideration?

Drawing from this argument, it can be added that, if CLP rewards are granted to customers as a way of thanking the customer for choosing that specific business to purchase their

goods or services from as proposed by Corbishley (2017:47), then it can furthermore be argued that the CLP rewards are granted to the customer in exchange for the customer choosing that specific business to purchase from. If that is the case, the customer provided a *quid pro quo* upon the original purchase in the form of choosing to purchase from that business as opposed to any other. In other words, the customer gave preference to that specific supplier, and in exchange, the business grants CLP rewards to the customer. However, before concluding that the consideration given by the customer for the CLP rewards is the patronage towards to CLP operator, it is necessary to consider the following brief example.

### **Example 2: Member vs Non-member of CLPs**

Company A operates a CLP where customers obtain 1 reward point for each R10 spent. Each reward point is worth R1, and points may be used to purchase goods or services from Company A. Company B, on the other hand, does not offer a CLP.

Customer X, a member of Company A's CLP, purchases qualifying goods to the value of R100 000. The goods were immediately delivered to Customer X. Customer Y, on the other hand, is not a member of Company A's CLP. Customer Y purchases the same qualifying goods to the value of R100 000 from Company A.

Customer X, by virtue of their membership of Company A's CLP, earns 10 000 CLP points. Customer Y, who made the same purchase of the same goods at the same price from the same supplier, does not earn any CLP points, as they are not a member of Company A's CLP.

Customer X and Customer Y both paid R100 000 for the same goods, however, Customer X receives not only the qualifying goods purchased from Company A, but also receives 10 000 CLP points for the exact same price Customer Y purchased the same qualifying goods at.

Despite both customers paying R100 000 to Company A, Customer X received CLP points in addition to the qualifying goods purchased, whereas Customer Y did not receive any CLP points and only received the qualifying goods purchased.

After considering Example 2, it is clear that both customers mentioned in the example gave preference to Company A when deciding where to purchase the qualifying goods from, however, Customer X received CLP points, whereas Customer Y did not. Therefore, based

on the example, it is clear that CLP rewards are not granted in exchange for the giving of preference to one company over another. Instead, in order to justify the difference between Customer X receiving CLP rewards and Customer Y not, Customer X must have given Company A something in addition to the R100 000 consideration for the qualifying goods purchased, as Customer Y paid the exact same consideration, but received less in exchange for it.

In order to clarify the purpose or objective under which CLP rewards are granted to customers in South Africa, it is necessary to consider the terms and conditions of the three most-used CLPs of 2021 in South Africa.

#### *2.2.3.2. Implied objectives of the three most-used CLPs of 2021 in South Africa*

Pick n Pay Stores Limited (Pick n Pay) Smart Shopper CLP is the most-used CLP of 2021 in South Africa (Cromhout, 2021:15). When referring to the terms and conditions of Pick n Pay's Smart Shopper CLP, the following is included therein:

“The Smart Shopper Loyalty Program tailors its offers to meet a customer's specific needs. To achieve tailored offers and facilitate the earning of certain benefits (such as the accrual of points) via PnP's partners, customer information is collected (limited to facilitate the intended purpose) and analysed in accordance with our Privacy Statement” (Pick n Pay Stores Limited, 2022d).

(Own emphasis)

Pick n Pay's Privacy Statement, in turn, clarifies that customer information is collected for various purposes, including analysing transaction history of a customer for use by Pick n Pay's internal commercial team, suppliers and business partners to provide the customer with relevant content or offers and assist business partners in marketing products and services (Pick n Pay Stores Limited, 2022c). The terms and conditions of the second most-used CLP of 2021 in South Africa, which is the Clicks Retailers (Pty) Ltd (Clicks) Clicks ClubCard must also be considered (Cromhout, 2021:15).

The following can be extracted from the Clicks ClubCard's terms and conditions:

“By applying to become a ClubCard member, or in the case of existing members, by continuing his/her membership of ClubCard, each ClubCard member consents to

- (a) his/her personal information [as defined in the Protection of Personal Information Act 4 of 2013] being processed by Clicks within the Clicks database;
  - (b) his/her personal information being shared within the Clicks group of companies;
  - (c) his/her personal information being shared with Affinity Associates and third parties who have a strategic marketing relationship with Clicks ...” (Clicks Retailers (Pty) Limited, Not dated-b).
- (Own emphasis)

Dis-Chem Pharmacies Ltd (Dis-Chem) on the other hand, which is the third most-used CLP of 2021 in South Africa, includes the following in its terms and conditions:

“The Benefit programme tailors its offers to meet the customer’s specific needs and in order to achieve this and to facilitate the earning of certain benefits, such as partner rewards and the accrual of Dis-Chem Benefit rewards, via Dis-Chem’s partners, your details may be passed to such partners. This information will be limited to only information required to facilitate an intended purpose. Please refer to our privacy policy available on [www.dischem.co.za](http://www.dischem.co.za) for further information” (Cromhout, 2021:15; Dis-Chem Pharmacies Limited, Not dated-b).

(Own emphasis)

Dis-Chem’s privacy policy notes that customer information is collected for the purposes amongst others, of conducting market research, sharing with third parties for market research and to enable Dis-Chem (and its associated companies) to develop marketing strategies in respect of its customers, and for direct marketing (Dis-Chem Pharmacies Limited, Not dated-a).

After considering the aforementioned companies’ CLP terms and conditions, along with any supporting policies and statements, it is clear that these companies collect customer information primarily for the purposes of marketing activities. This is in line with the objectives of a CLP as suggested by O’Malley (1998:51).

It is crucial for the purposes of this study to determine whether the CLP operator supplies the CLP reward or loyalty point for a consideration by the customer or not, as this may greatly influence the VAT implications thereof. The issue of whether CLP rewards are issued in exchange for a consideration is further explored under section 3.2.5.

### **2.3. UNDERSTANDING ACCOUNTING TREATMENT OF CLP REWARDS**

After having defined CLPs, it is necessary to consider the accounting treatment of CLP rewards. Briefly, IFRS requires entities to account for CLP rewards by deeming the amount the customer paid as consideration for both the goods or services purchased and for the CLP rewards allocated. The rewards granted to the customer are treated as a separate component of the sales transaction, and the business providing these rewards must allocate revenue received from the customer between the revenue received for the goods and services supplied and a liability to provide the rewards in future when a customer redeems them (IFRS Foundation, 2021). Upon redemption, the liability is derecognised, and revenue is finally recognised in respect of the rewards granted. Consequently, revenue received in respect of the rewards granted is deferred to the future date at which the customer redeems the rewards. IFRS, therefore, deems the customer to pay for the points in money. The accounting treatment of CLP rewards is an antithesis of the approach followed by SARS in Interpretation Note 118, which is discussed in detail under section 3.4 where points allocated to the customer are granted for no consideration. A deeper investigation into the accounting treatment of CLP rewards is therefore necessary and is discussed below.

Prior to 2018, the deferred revenue presented in the annual financial statements of businesses who offer CLPs was presented based on IFRIC 13, a component of IFRS (IFRS Foundation, 2021). However, from IFRIC 13's implementation date in January 2013, it was heavily criticised as the deferred revenue (revenue linked to the CLP rewards) presented in the annual financial statements and was entirely dependent on company-specific judgement and interpretation of IFRIC 13 (Johansson & Ringius, 2007:12). Due to an increase in the use of CLPs by entities, a need arose for the International Accounting Standard Board 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, as from 1 January 2018, IFRIC 13 and its related standards were superseded by IFRS 15 (Deloitte Touche Tohmatsu Limited, 2016:2-3). IFRS 15 requires companies to implement a five-step approach to recognise, measure, and present revenue and deferred revenue received from a customer (Dili, 2017:1; International Accounting Standards Board, 2018). It is necessary to understand the application of the five-step approach required by IFRS 15 in respect of CLPs for the purposes of this study, as it will clearly display the accounting treatment of CLP rewards granted and redeemed and may assist in understanding the VAT taxability of CLP rewards in terms of the South African VAT framework.

The accounting of revenue prescribed by IFRS 15 can be summarised into the following five steps, namely:

“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” (International Accounting Standards Board, 2018:870).

The five-step approach followed in IFRS 15 will be discussed in further hereafter. Step 1 gives guidance on how to identify the contract with a customer. Step 2 indicates how performance obligations must be identified. A performance obligation is each promise in the contract to transfer goods or services to the customer (International Accounting Standards Board, 2018:910). Step 3 provides guidance on determining the transaction price, which is the amount of consideration the entity expects to be entitled to in exchange for transferring promised goods and services (International Accounting Standards Board, 2018:888). Step 4 indicates how the total transaction price must be split between each performance obligation. The total transaction price must be allocated to each performance obligation on a relative stand-alone selling price basis (International Accounting Standards Board, 2018:896). Step 5 indicates when revenue may be recognised. The crux of step 5 is that revenue may only be recognised once the customer obtains control over the goods or services provided. Briefly, a customer obtains control over the goods or services once the customer has the ability to direct the use of and obtain substantially all of the benefits from the goods or services (International Accounting Standards Board, 2018:881).

IFRS 15 views the supply of goods or services and the granting of CLP rewards as two separate performance obligations. The transaction price is the full price (selling price) of the goods or services supplied and must be allocated (split) between the two performance obligations, that being the supply of goods or services and CLP rewards granted. Once the transaction price is allocated between the aforementioned two performance obligations, the revenue relating to the supply of goods or services may be recognised upon the time of supply to the customer, since the customer obtains control of the goods or services upon the time of supply and thus the performance obligation is satisfied. The portion of the revenue allocated to the CLP rewards granted must be recognised as a contract liability and

may only be recognised as revenue when the rewards have been redeemed by the customer, or upon expiry of the CLP rewards. Notably, the allocation of the transaction price between the goods or services supplied and CLP rewards granted, effectively results in a reduction in profit for the CLP provider. The reason being, in the year during which the goods or services are supplied, the entity can only recognise a portion of revenue relating to the goods or services. The portion of revenue relating to the CLP rewards is deferred. However, the full cost of the goods or services is taken into account via cost of sales or operating expenses during the year of sale.

“Contract liability” is the term used in IFRS 15 for the liability account that is created due to the entity’s obligation to transfer goods or services to a customer for which payment has already been received by the company (International Accounting Standards Board, 2018:910). When considering CLP rewards, the portion of the transaction price allocated to the CLP rewards granted results in a contract liability, since the entity has an obligation to provide the CLP rewards and the consideration for these CLP rewards granted is deemed to have already been received by the entity. This consequently also represents a deferral of revenue on the initial transaction. Essentially, the contract liability is an account to temporarily store the value of CLP rewards that are ‘owed’ to the customer (International Accounting Standards Board, 2018:963-964).

The manner in which revenue relating to the CLP rewards is allocated to these rewards is based on the provider’s expectation of how much of the CLP rewards will be exercised which refers to customers utilising or redeeming their CLP rewards. This expectation is determined by each individual provider by analysing past redemption of CLP rewards to predict future redemption (International Accounting Standards Board, 2018:964). It is important to note that IFRS 15 does not prescribe an exact formula for an entity to use in allocating a portion of the revenue to CLP rewards; it only requires an entity to allocate the transaction price on a stand-alone selling price basis to each performance obligation. The entity, therefore, has to determine the stand-alone selling price of the CLP rewards (as well as the underlying goods and services sold) and estimate the likelihood of the customer exercising their points; however, this estimate is made by the entity itself and is consequently subjective. The CLP reward revenue allocated in this manner, may only be recognised as revenue when this CLP reward is exercised or has expired (International Accounting Standards Board, 2018:881). A short example of the operation of IFRS 15 is provided in Example 3 below.

### Example 3: Accounting treatment of the granting of CLP rewards

Company A operates a CLP where customers obtain 1 reward point for each R10 spent. Each reward point is worth R1, and points may be used to purchase goods or services from Company A. Customer X purchases qualifying goods to the value of R100 000 and earns 10 000 CLP points worth R1 each, thus R10 000. The goods were immediately delivered to Customer X.

Assuming there is a contract with a customer, IFRS 15 requires Company A to identify the performance obligations that arose from this contract with the customer. From the perspective of Company A, two performance obligations arose from the sale of goods to Customer X, that is, the obligation to provide goods and the obligation to grant 10 000 points to Customer X.

The transaction price is R100 000, as this is the amount Company A expects to be entitled to, and must be allocated to the supply of goods and supply of points on a relative stand-alone selling price basis. In this instance, the stand-alone selling prices of the goods sold and points granted are R100 000 and R10 000 respectively. This was determined as the goods sold are valued at R100 000 and the 10 000 points granted are worth R1 each. In total, thus R110 000.

Accordingly, the transaction price of R100 000 is allocated as follows:

<b>Performance obligation</b>	<b>Transaction price</b>
Goods	R90 909.09
Points	R9 090.91
	<b>R100 000</b>

The above allocation was determined as follows:

The sum of the stand-alone selling prices of the performance obligations is R110 000, that is, R100 000 for the goods sold and R10 000 for the points granted. Consequently, the portion of the transaction price of R100 000 allocated to goods is R90 909.09 [ $R100\ 000 \times (R100\ 000 \div R110\ 000)$ ] and the portion of the transaction price of R100 000 allocated to points granted is R9 090.91 [ $R100\ 000 \times (R10\ 000 \div R110\ 000)$ ].

Company A is required to recognise revenue relating to each performance obligation when the performance obligation is satisfied, that is, when the customer obtains control over the goods or services. Since the goods were immediately delivered, Company A may recognise revenue amounting to R90 909.09 immediately. Company A may only recognise the remaining revenue of R9 090.91 relating to the 10 000 points when the points are redeemed.

From the example above, it is clear that IFRS 15 recognises the CLP rewards granted as goods or services in its own right, to which a value can be attributed. IFRS 15 is a valuable resource for this study, since at least 167 jurisdictions apply IFRS accounting standards (IFRS Foundation, 2022). However, it is important to note that the tax treatment of transactions and events are not dependent on the accounting treatment thereof and often differs, as has been determined in many court cases including *Stellenbosch Farmers' Winery v Commissioner for the South African Revenue Service*, 2012 (5) SA 363 (SCA) and *Commissioner for the South African Revenue Service v Volkswagen South Africa (Pty) Ltd*, 2019 (2) SA 362 (SCA).

## **2.4. CONCLUSION**

Chapter 2 provided a literature review, wherein relevant literature was studied in order to amongst others, describe and define a CLP for the purposes of this study. Furthermore, a transactional flow of CLPs was provided to aid in understanding the operation of CLPs along with an illustrative example. In addition, the objectives of a CLP were discussed in order to determine the motive under which CLP rewards are granted. That being said, this chapter considered whether CLP rewards are provided for a *quid pro quo* or whether it is seen to be a donation by the CLP operator to the CLP member. This chapter furthermore aimed to contribute to the main arguments in current literature regarding the VAT taxability of CLP rewards. In this regard, this chapter reasoned that the granting of CLP rewards to CLP members is indeed not a donation; it may also be argued that a *quid pro quo* in the form of customer information, is provided as consideration by the customer in exchange for CLP rewards. This was further explored by considering the specific purpose(s) of the three most-used CLPs of 2021 in South Africa, all three of which revealed that the gathering of customer information is at the forefront of the objectives of these selected CLPs. Lastly, Chapter 2 discussed the accounting treatment of the granting of CLP rewards, as the accounting treatment may provide guidance in determining the VAT consequences arising from the supply of CLP rewards. However, the relevant literature pertaining to the VAT treatment of CLP rewards granted to CLP members in South Africa was, due to its comprehensiveness, deliberately omitted from this chapter and will be addressed in-depth in Chapter 3.

## **CHAPTER 3: VALUE-ADDED TAX ON CLP REWARDS IN SOUTH AFRICA AND RELEVANT GUIDANCE FROM OTHER JURISDICTIONS**

### **3.1. INTRODUCTION**

The taxability of CLP rewards within the South African VAT framework is predominantly unclear. In 2014, SARS held discussions regarding CLPs with relevant stakeholders and thereafter issued a Discussion Paper in the same year (PricewaterhouseCoopers, 2020). The Discussion Paper was followed by a Draft Interpretation Note in 2020, which invited the public to comment on SARS's position regarding the VAT treatment of CLP rewards for all members involved in CLPs (CLP operator, member, loyalty partner(s) and redemption partner(s)) (PricewaterhouseCoopers, 2020). This Draft Interpretation Note has subsequently been converted into a finalised Interpretation Note 118, which provides SARS's position on the VAT consequences of points-based loyalty programmes (SARS, 2021b). Although Interpretation Note 118 provides useful clarity on the VAT implications of points-based CLPs, commentators such as Van Schalkwyk (2021:2-4) have raised concerns regarding certain aspects contained within Interpretation Note 118.

Van Schalkwyk (2021:4) notes that Interpretation Note 118 achieves neutrality from a VAT perspective for all parties involved in a CLP, except in one instance. The exception is where the redemption partner is reimbursed by the LPO at an amount less than the value of the points redeemed, in which case no corresponding input tax deduction is available to the redemption partner for the difference between the value of the points redeemed and the reimbursement. Consequently, the redemption partner will pay VAT on an amount higher than the actual consideration received, which is contrary to the operation of the South African VAT system (Van Schalkwyk, 2021:4). Furthermore, Interpretation Note 118 compares a loyalty point granted to a 'token, voucher or stamp' as envisaged under sections 10(18) and 10(19), however, it notes that sections 10(18) and 10(19) are only applicable when loyalty points are issued for a consideration, which is uncommon, as loyalty points are generally issued for no consideration (SARS, 2021b:8-9, 12-13; Van Schalkwyk, 2021:4). Nonetheless, Interpretation Note 118 considers the VAT implications when loyalty points are issued for a consideration as well as when issued for no consideration. The aforementioned criticisms of Interpretation Note 118 open the floor for a discussion on the VAT implications

of CLPs, since the VAT treatment thereof is still unclear. The detail of Interpretation Note 118 will be considered under section 3.4.

The Draft Interpretation Note, on which Interpretation Note 118 is based, and which was the only resource issued by SARS at the time, has been considered by researchers such as Geerlings (2021) along with the charging section and international practice regarding the VAT treatment of CLPs. Geerlings (2021:28) found that the charging section is met in terms of loyalty points granted in respect of CLPs. However, it was also noted that the accounting treatment of CLPs can be applied to the VAT treatment thereof, whereby the consideration paid by the customer for the goods or services can be allocated between the goods or services purchased (original supply) and the loyalty points issued. Consequently, the VAT treatment of CLP rewards is still uncertain.

Despite the uncertainty regarding the VAT implications of CLP rewards, three main schools of thought exist regarding the VAT consequences of CLPs, as has been considered by Geerlings (2021); IFRS (2018) (in terms of accounting treatment used to determine VAT consequences); SARS (2021b) as well as the present study. Briefly, the first school of thought is of the opinion that a customer participating in a CLP will receive the CLP reward for free. In other words, the customer pays for the goods or services acquired from the CLP operator, the CLP operator then grants CLP rewards to the customer at no additional cost to the customer. The second school of thought, however, supposes that the customer participating in a CLP is in fact, paying for the CLP reward in money. This school of thought, which is drawn from the accounting treatment of CLP rewards granted, regards the amount paid by the customer to the CLP operator for the goods and/or services purchased as comprising a part-payment for the goods and/or services purchased, and a part-payment for the CLP rewards granted. The third and final school of thought, which this study aims to contribute, suggests that the customer provides a consideration for CLP rewards, in the form of customer information.

### **3.2. THE CHARGING SECTION**

Section 7 of the VAT Act provides for the heart of the VAT Act which contains, amongst others, section 7(1)(a), which is commonly referred to as “the charging section” (Schneider, 2000:56). Contained within section 7 of the VAT Act is sections 7(1)(a), (b) and (c). Sections 7(1)(b) and (c) address the levying of VAT on the importation of goods and services

respectively, which is not relevant for the purposes of this study. Section 7(1)(a) applies to the bulk of supplies falling within the ambit of the VAT Act, and reads:

“Subject to the exemptions, exceptions, deductions, and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax –

(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him” (South Africa, 1991).

(Own emphasis)

From reading section 7(1)(a) it is evident that in order for VAT to be raised, the following four requirements must be met:

- supply
- by a vendor
- of goods or services
- in the course or furtherance of any enterprise (South Africa, 1991).

Each of the aforementioned requirements contain terms that are specifically defined in section 1(1) of the VAT Act. Consideration must thus be given to each of these definitions.

### **3.2.1. Supply**

‘Supply’ is defined in section 1(1) of the VAT Act as:

“includes performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected ...” (South Africa, 1991).

Consequently, the definition of ‘supply’ is very broad and thus merely requires performance by one person to another. Performance is defined as, “the fulfilment of a claim, promise or request” (Merriam-Webster Dictionary, n.d.-a). It therefore follows that a ‘supply’ can only take place when at least two persons are involved, that being, the supplier and the recipient.

Evidently, the granting or issuing of a loyalty point by a CLP operator to a member of the CLP falls within the scope of the definition of a ‘supply’ in section 1(1) of the VAT Act. This is because two persons are involved, namely the CLP operator and the member of the CLP.

The CLP operator is performing in terms of its promise to provide the member with loyalty points upon a qualifying purchase, as a consequence of the membership agreement between the CLP operator and member.

### **3.2.2. Vendor**

Section 1(1) of the VAT Act defines a 'vendor' as any person who is or is required to be registered under the VAT Act (South Africa, 1991). Section 23 of the VAT Act elaborates on the registration requirements as a VAT vendor. For the purposes of this study, it is assumed that the CLP operator is a registered VAT vendor, although this may not be the case with all CLPs.

### **3.2.3. Goods**

'Goods' is defined in section 1(1) of the VAT Act as, "corporeal movable things, fixed property, any real right in any such thing or fixed property, and electricity" and excludes money, a right under a mortgage bond or pledge of such property and, "any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament ..." (South Africa, 1991).

The supply of a loyalty point by a CLP operator is consequently not the supply of goods, as a loyalty point is not corporeal nor movable or fixed property, electricity or a real right in fixed property. Therefore, it is important to consider the definition of 'services' for this study.

### **3.2.4. Services**

Section 1(1) of the VAT Act defines 'services' as:

"anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph I of the definition of 'goods'" (South Africa, 1991).

(Own emphasis)

As discussed under section 2.2.1, CLP rewards do not meet the definition of 'money' as defined in section 1(1) of the VAT Act and is consequently not excluded from the definitions of goods or services.

It is therefore clear that the granting or issuing of a loyalty point by the CLP operator to the member of the CLP is a 'service' as defined in section 1(1) of the VAT Act. This is because the loyalty point represents a right granted by the CLP operator to the CLP member, namely to tender the loyalty point as payment or part-payment at a redemption partner, which for the purposes of this study is assumed to be the CLP operator, for the acquisition of goods or services in future. This view is also held by SARS in Interpretation Note 118 (SARS, 2021b:7).

### **3.2.5. In the course or furtherance of an enterprise**

'Enterprise' is defined in section 1(1) of the VAT Act as:

"in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club"

(South Africa, 1991).

(Own emphasis)

What is critical to note (for the purposes of this study) from the definition of 'enterprise' is that a supply is only made in the course or furtherance of an enterprise if it is made for a consideration. Section 1(1) and 10(3) of the VAT Act address the meaning of the term 'consideration'. Section 1(1) of the VAT Act defines 'consideration' as,

"... includes any payment made or to be made ... whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain" (South Africa, 1991).

Section 10(3) of the VAT Act, on the other hand, clarifies the value to be placed on the consideration as being the amount of money, if payment was made in money, or the open market value of the payment if the payment is anything other than money (such as a barter transaction) (South Africa, 1991).

From the perspective of CLPs, two main questions then arise: Firstly, are loyalty points granted by the CLP operator to the member of the CLP a supply for a consideration? If so,

is the consideration given by the member in money (which is included in the transaction price), or in kind as a barter transaction, in the form of customer information? If one considers the approach of IFRS 15 to allocate the transaction price between the underlying goods or services supplied and the loyalty points granted (as discussed under section 2.3), it seems that the recipient pays for the loyalty points in money. If one assumes a barter transaction, for example, the customer provides a consideration for the supply of the loyalty point in the form of his personal information being provided, as discussed under section 2.2.3.1, then another question arises: What is the open market value of the customer's personal information? It can be argued that the aforesaid value is based on the value of the CLP rewards granted. However, SARS Interpretation Note 118, as discussed under section 2.2.1, defines a 'loyalty programme' as one where the customer does not pay for the allocation of loyalty points (SARS, 2021b). Moreover, if it is argued that the customer does not pay for the allocation of loyalty points, it will then be suggested, by implication, that the business grants CLP rewards or loyalty points with a motive of 'sheer liberality' or 'disinterested benevolence', as discussed under section 2.2.3.1. If this is the case, the donation will generally not be regarded as being in the course or furtherance of an enterprise, unless the vendor is a welfare organisation (SARS, 2021a:17).

The issue of whether loyalty points are granted to customers for a consideration continues its relevance in the following section, where it is noted that sections 10(18) and 10(19) of the VAT Act both require a 'token, voucher or stamp' to be issued for a "consideration in money" (Badenhorst, 2021). The aforementioned sections, amongst others, will be discussed next including other provisions relevant to this study.

### **3.3. SPECIFIC PROVISIONS RELEVANT TO CLPS**

Section 10 of the VAT Act provides for the value of a supply of goods or services, and specifically addresses a 'token, voucher or stamp' under sections 10(18), 10(19) and 10(20) (South Africa, 1991). It is necessary to consider whether a loyalty point granted under a CLP can be equated to a 'token, voucher or stamp' as contemplated under the aforementioned sections, as the VAT treatment of loyalty points may then be clarified by these sections if assumed they are provided for a consideration in money. Furthermore, consideration must be given to section 10(23), which addresses a supply made for no consideration.

### 3.3.1. Meaning of ‘token, voucher or stamp’

As noted, sections 10(18), 10(19) and 10(20) address the VAT treatment of a ‘token, voucher or stamp’ (South Africa, 1991). The words ‘token, voucher or stamp’ are not defined in the VAT Act and has not been addressed by the judiciary. Consequently, one must refer to the ordinary dictionary meaning.

A ‘voucher’ is defined by Merriam-Webster Dictionary (n.d.-b) as, “a form or check indicating a credit against future purchases or expenditures” or “a documentary record of a business transaction”. Oxford Dictionary (n.d.), in turn, defines a ‘voucher’ as “a printed piece of paper or electronic code that can be used instead of money to pay for something, or that allows you to pay less than the usual price of something”. As such, a loyalty point can be equated to a ‘token, voucher or stamp’, as loyalty points granted under CLPs entitle the holder thereof to use the loyalty point instead of money to pay for something. The definition laid out by the Oxford Dictionary (n.d.) includes a ‘token, voucher or stamp’ as envisaged under section 10(20), where the holder thereof is entitled to a discount.

Furthermore, section 1 of the CPA defines a “loyalty credit or award” as any:

- “(a) benefit accruing to a customer,
  - (b) right to any goods, service or other benefit granted to a customer, or
- I point, credit, token, device, or other tangible or intangible thing which, when accumulated in sufficient quantities, entitles the holder to seek, request or assert a claim for any goods, service or other benefit, allocated to a customer,
- in terms of a loyalty programme, irrespective of the name, nature, form or characterisation assigned by that loyalty programme to any such goods, service or other benefit, right or thing” (South Africa, 2008).

As noted under section 2.2.1, section 35(1) of the CPA deems “loyalty credits or awards” as “a legal medium of exchange when offered or tendered as consideration for any goods or services offered, or transaction contemplated, in terms of that loyalty programme” (South Africa, 2008) (own emphasis). Consequently, it is clear from the CPA that a ‘loyalty credit or award’, such as a loyalty point, has the characteristics of money and aligns itself with the definition of ‘voucher’ in both Merriam-Webster Dictionary (n.d.) and Oxford Dictionary (n.d.) as previously discussed as well as ‘token, voucher or stamp’ under sections 10(18), 10(19) and 10(20) of the VAT Act. It is important to note that the CPA does not regard a ‘loyalty

credit or award' as a legal medium of exchange in general at all retailers. Instead, it is regarded as a legal medium of exchange in terms of the specific loyalty programme, and may thus be offered as payment or part-payment at a redemption partner participating in the CLP. Therefore, since it has been established that loyalty points granted under CLPs are considered a 'token, voucher or stamp' under sections 10(18), 10(19) and 10(20), it is necessary now to consider the specific provisions in the aforementioned sections and how this relates to the VAT treatment of CLP rewards (SARS, 2021b:7).

Briefly, section 10(18) of the VAT Act requires a vendor to disregard the supply of a token, voucher or stamp issued for a consideration in money, to the extent of a monetary value stated on such token, voucher or stamp (South Africa, 1991). Section 10(19), on the other hand, provides that where a token, voucher or stamp is issued for a consideration in money and such token, voucher or stamp entitles the holder thereof to receive goods or services specified on such token, voucher or stamp, or which by usage or arrangement entitles the holder to specified goods or services, without any further charge, the value of the supply of such goods or services upon surrender of the token, voucher or stamp is deemed to be nil (South Africa, 1991). It is therefore important to delve into the intricacies of sections 10(18) and 10(19), in order to determine its possible application to loyalty points.

### **3.3.2. 'Token, voucher or stamp'**

As noted, section 10(18) of the VAT Act requires a vendor to disregard the supply of a token, voucher or stamp issued for a consideration in money, to the extent of a monetary value stated on such token, voucher or stamp (South Africa, 1991). The Explanatory Memorandum (which accompanied the VAT Bill before it was enacted) states in paragraph 5.16.15(a), that vouchers under section 10(18) are regarded as a medium of exchange similar to money (Kruger, 2022:18). Section 10(18) fits squarely into the principles underpinning the VAT Act, as the supply of money is neither 'goods' nor 'services' as defined in section 1(1), and consequently, the supply of a token, voucher or stamp with a monetary value stated, is comparable to the supply of money itself, and should not attract VAT on the issues thereof but only upon redemption (South Africa, 1991). It is important to note that section 10(18) requires the token, voucher or stamp to be supplied for a consideration in money (own emphasis), which means that the recipient thereof had to pay, in money, for the token, voucher or stamp (South Africa, 1991). In the context of CLPs, arguments exist for both the fact that customers are providing a consideration in money to the company providing the

CLP (evidenced by the interpretation and treatment of CLPs under IFRS 15, as discussed under section 2.3, and further considered under section 2.2.3.1), and that they are not (also discussed under section 2.2.3.1). As noted by Ponnann JA in *Commissioner for the South African Revenue Service v Respublica (Pty) Ltd*, 2018 SA (A) (81 SATC 175) at 12, it is a general principle, also recognised in other VAT jurisdictions, to refer to the contractual arrangements under which the supply is made to determine the VAT consequences of the supply. In the context of CLPs, the member of the CLP and the CLP operator enter into a membership agreement, which is often laid out in the CLPs terms and conditions. Therefore, according to Cromhout (2021:15), consideration must be given to the three most-used CLPs of 2021 in South Africa as well as the eighth most-used CLP (which qualify as a CLP for the purposes of this study, that is, where loyalty points are issued instead of granting an upfront discount).

Pick n Pay Stores Limited's (Pick n Pay) Smart Shopper CLP is the most-used CLP of 2021 in South Africa (Cromhout, 2021:15). When referring to the terms and conditions of Pick n Pay's Smart Shopper CLP, it is noted, under point 12 of the terms and conditions, that, "the Smart Shopper card may be used as a: Loyalty card, PnP Wallet and Store card or to be used as a card to present for another linked service purchase ie.: WebTicket" (Pick n Pay Stores Limited, 2022d). Point 14 of the terms and conditions of Pick n Pay's Smart Shopper card elaborates that a 'PnP Wallet' is pre-loaded and activated on each registered Smart Shopper card, and that the 'PnP Wallet' "can be used as a valid tender on all products and services sold at PnP" (Pick n Pay Stores Limited, 2022d).

The second most-used CLP of 2021 in South Africa is Clicks Retailers (Pty) Ltd (Clicks) Clicks ClubCard (Cromhout, 2021:15). The Clicks ClubCard terms and conditions make reference, under point 9 of the terms and conditions, that points earned are converted to a monetary value (Clicks Retailers (Pty) Limited, Not dated-a). Dis-Chem Pharmacies Ltd (Dis-Chem), which is the third most-used CLP of 2021 in South Africa, states under point 14 of its Dis-Chem Benefit Programme CLP terms and conditions that, "the value of rewards accumulated on the member's Benefit Card profile can be used for payment of purchases at participating Dis-Chem Stores" (Cromhout, 2021:15; Dis-Chem Pharmacies Limited, Not dated-b). Lastly, First National Bank's (FNB) CLP, eBucks, the eighth most-used CLP of 2021 in South Africa, will be considered since the fourth, fifth, sixth and seventh most-used CLPs do not meet the definition of a CLP for the purposes of this study, since these CLPs

provide upfront discounts or cash back as opposed to loyalty points. The terms and conditions of FNB's eBucks notes that, "eBucks is for free in that We [FNB] will not charge You [member] to earn eBucks" and furthermore notes that only two of the eBucks loyalty partners, FNB and RMB Private Bank, may charge the member a credit card monthly rewards fee (FirstRand Bank Limited, Not dated).

Based on the aforementioned, it is clear that CLP rewards, as discussed under section 2.2.1, are considered to be a legal medium of exchange, which is in accordance with section 35 of the CPA (South Africa, 2008). Furthermore, it is worthy to note, as determined under the terms and conditions of the aforementioned CLPs, that the loyalty points can be converted to a monetary value, and may be used as a legal medium of exchange as payment or part-payment for goods or services in terms of that loyalty programme. It can therefore be argued that the granting of loyalty points (if granted for a consideration in money), falls within the ambit of section 10(18) of the VAT Act. Whether or not the loyalty points are issued for a consideration in money, is however, not clear. Therefore, it is important to delve deeper into the provisions of section 10(18).

In *Mobile Telephone Networks (Pty) Limited v Commissioner for the South African Revenue Service*, 2021 ZAGPPHC 1, the case addressed the issue where the applicant, Mobile Telephone Networks (Pty) Ltd (MTN), had supplied two forms of vouchers, a single-purpose voucher and a multi-purpose voucher. According to MTN's argument, a single-purpose voucher entitles the holder to specific goods or services, whereas a multi-purpose voucher (also dubbed an 'airtime voucher' by MTN) may be used, once activated, by the holder for any of MTN's products or services. MTN held that section 10(18) applied to the issue of a multi-purpose voucher, as MTN contended that this voucher is effectively currency used to purchase products or services, of the holder's choice, from MTN. On the other hand, SARS argued, in *Mobile Telephone Networks (Pty) Limited v Commissioner for the South African Revenue Service*, 2021, that a multi-purpose voucher as supplied by MTN falls within the ambit of section 10(19), since "the recipient of the voucher is entitled on the surrender thereof to receive goods or services that by usage or arrangement entitles the holder to specified goods or services".

The court considered the Explanatory Memorandum to the VAT Act, specifically paragraphs 5.16.15(a) and (b), which noted that section 10(18) applies to a token, voucher or stamp

which has a monetary value stated thereon and is granted for a consideration in money, in other words, a gift voucher, which is regarded as a medium of exchange similar to money (Kruger, 2022:18). Furthermore, the court noted that section 10(19) applies to a token, voucher or stamp issued for a consideration in money whereby the holder is entitled to goods or services specified on such token, voucher or stamp, or which by usage or arrangement entitles the holder to specified goods or services without further charge. The court therefore concluded in *Mobile Telephone Networks (Pty) Limited v Commissioner for the South African Revenue Service*, 2021 that the multi-purpose voucher issued by MTN is not similar to a gift voucher, which is a means of payment for goods or services, since the multi-purpose voucher (or 'airtime voucher') can be used to make calls, receive calls, send messages, use the internet and for data. As such, the court held that the multi-purpose voucher is a voucher for 'airtime', which is a specified good or service, and consequently, section 10(19) was applicable to such a voucher.

Considering the decision of the High Court in *Mobile Telephone Networks (Pty) Limited v Commissioner for the South African Revenue Service*, in the context of loyalty points, it is clear that a loyalty point will most likely (depending on the facts and circumstances of the relevant CLP) fall within the ambit of section 10(18), since, although the loyalty points are used by the recipient to obtain goods or services, such goods or services are not clearly specified. In *Mobile Telephone Networks (Pty) Limited v Commissioner for the South African Revenue Service*, the multi-purpose voucher (or 'airtime voucher') allowed the holder of the voucher to make use of certain MTN's services (such as make calls, browse the internet, etcetera), whereas a loyalty point in terms of a CLP, as evidenced by the selected aforementioned CLPs and in terms of section 35(1) of the CPA, allows the member to tender such loyalty points as a legal medium of exchange for any goods or services in terms of the respective CLP (South Africa, 2008). Moreover, section 35(1) of the CPA opens with the specific wording "Despite any provision in any law, agreement or notice to the contrary ..." (South Africa, 2008). Therefore, it is unlikely that section 10(19) applies to loyalty points, since, in terms of section 35(1) of the CPA, the member will be allowed to tender loyalty points as consideration for any (own emphasis) goods or services, in other words, not specified goods or services, regardless of the terms and conditions of, or agreement with, the member in terms of a CLP (South Africa, 2008).

Moreover, section 63(1) of the CPA addresses transactions in which a supplier accepts consideration from a person in exchange for a prepaid certificate, card, credit, voucher, or similar device (hereinafter referred to as ‘voucher’) and agrees to provide goods or services to any person who subsequently surrenders such a voucher, up to the value represented by it (South Africa, 2008). Section 63(3) states that the consideration (own emphasis) paid by a consumer to a supplier in exchange for such a voucher is the property of the bearer (own emphasis) of such device to the extent the supplier has not redeemed it (South Africa, 2008). The implication of this section is that the value attributed to the aforementioned voucher is a value in the hands of the holder, and may thus be used in exchange for goods or services.

The most significant issue drawn from the above is whether a loyalty point is issued for a consideration, because if it is issued for no consideration, section 10(18) (or section 10(19)) will not apply to such loyalty point. The issue of whether loyalty points are issued for a consideration or not was discussed under section 2.2.3.1. If it is so that loyalty points are issued for no consideration, it will be necessary to consider section 10(23) of the VAT Act.

### **3.3.3. Supply for no consideration (s 10(23))**

Section 10(23) of the VAT Act provides the value of a supply made for no consideration, and states:

“Save as otherwise provided in this section, where any supply is made for no consideration the value of that supply shall be deemed to be nil” (South Africa, 1991).

The wording “save as otherwise provided in this section ...” indicates that section 10(23) is only applicable to a supply if there is no other subsection in section 10 which specifically addresses the supply. Therefore, section 10(23) only needs to be considered if section 10(18) or 10(19) does not apply to the supply of loyalty points. Furthermore, the issue of whether a loyalty point is issued for a consideration or not was discussed under section 2.2.3.1, where it was found that it is unlikely that loyalty points are issued for no consideration. This is due to the objectives of a CLP, such as the gathering of information of customers, marketing, and other objectives.

#### **3.3.3.1. *Commissioner for the South African Revenue Service v Capitec Bank Limited***

In *Commissioner for the South African Revenue Service v Capitec Bank Limited*, 2022 SA JOL 54201 (SCA), the respondent, Capitec Bank Limited (Capitec), had entered into

unsecured loan contracts with its customers. In terms of these loan contracts, Capitec provided its customers with loan cover, the proceeds of which, if paid out, were applied to settle or reduce the outstanding balance on the loan in the event of the borrower's death or retrenchment. Capitec furthermore paid premiums to Guardrisk Life Limited, who underwrote the aforementioned loan cover, in terms of which Capitec was the insured and becomes entitled to the insurance proceeds if the customer dies or is retrenched and is unable to settle the debt. Capitec claimed roughly R71.5 million as a notional input tax deduction under section 16(3)(c) of the VAT Act on the total insurance proceeds received by Capitec in respect of this loan cover.

SARS, however, argued that Capitec was not entitled to an input tax deduction in terms of section 16(3)l of the VAT Act, because the supply of the loan cover did not constitute a "taxable supply". The reason being, as SARS argued in *Commissioner for the South African Revenue Service v Capitec Bank Limited*, 2022, Capitec did not charge the borrower any consideration in respect of the loan cover and that the loan cover was supplied in the course of Capitec's business of providing credit to customers, which is an exempt supply under section 12(a) of the VAT Act.

Section 16(3)l allows a vendor to claim an input tax deduction on an amount equal to the tax fraction of any payment made by the vendor to indemnify another person in terms of a contract of insurance, provided that the supply of the contract of insurance is a taxable supply (South Africa, 1991). The court considered the purpose of VAT, in that it is a tax upon the final consumer, and therefore considered whether Capitec achieved an equilibrium in its books. The court noted that Capitec claimed input tax deductions on the insurance premiums paid to Guardrisk and furthermore noted that when Capitec's customer defaulted due to death or retrenchment, Guardrisk paid Capitec the insurance proceeds, which in turn, resulted in a deemed supply for Capitec under section 8(8) of the VAT Act and consequently, output tax being raised. Therefore, equilibrium was achieved in Capitec's books since both an input tax deduction and output tax was accounted for. The court held that Capitec attempted to claim input tax on the same deemed supply, which, would skew Capitec's books, since an input tax deduction would exist without any corresponding output tax, as the output tax raised in terms of section 8(8) is immediately reversed via the input tax deduction Capitec sought to claim.

Furthermore, the court held that the only supply between Capitec and its customers is the supply of credit, which is an exempt supply. The insurance obtained from Guardrisk by Capitec is not a taxable supply in relation to Capitec's customer. Capitec was insured against the 'outstanding loan amount' which constituted the amount of credit provided and the capitalised interest and fees, all of which are an exempt supply. Thus, because the provision of credit by Capitec to its customer is an exempt supply of financial services, the loan cover was supplied in the course of making an exempt supply and was therefore not deductible by Capitec as an input tax deduction.

From the aforementioned case it was found that the court considered the equilibrium in Capitec's books when making its decision. If the granting of a loyalty point to a member of a CLP at initial purchase of goods or services is considered, it is noted that the loyalty point will be used to purchase more goods or services in future, on which the business, if such goods or services are a taxable supply, will be able to claim an input tax deduction. This input tax deduction would then exist without corresponding output tax being raised, since output tax, currently, is only raised by the vendor after applying the consideration of the loyalty point upon the further purchase of goods or services. In other words, output tax is raised on the net amount after deducting the value of the loyalty point redeemed when the member purchases goods or services using their accrued loyalty points. The practice of raising output tax on the net amount after applying the loyalty points will be considered, with an example, under section 3.3.3.2. Regardless, if the loyalty point is indeed issued for no consideration in money, and no other subsection of section 10 of the VAT Act applies, the value of the supply of the loyalty point will be regarded as nil in terms of section 10(23) of the VAT Act. When considering supplies for no consideration, it is necessary to consider SARS Interpretation Note 70 (Issue 2).

#### *3.3.3.2. SARS Interpretation Note 70 (Issue 2)*

Where a vendor makes taxable supplies in the course or furtherance of an 'enterprise', output tax is levied on the supplies made and the vendor claims input tax on expenses incurred in making such taxable supplies. Supplies made in the course or furtherance of an 'enterprise' have to be made for a consideration, whether for a profit or not. If the supply is made for free, it is not in the course of an 'enterprise'. Section 10(23) deals with the situation where supplies are made for no consideration but are still deemed to be made in the course of the enterprise being carried on. SARS Interpretation Note 70 (Issue 2) clarifies that

whether the vendor must levy output tax and may claim input tax on supplies made for no consideration, depends on whether such a supply is regarded as being made in the course or furtherance of the vendor's enterprise or not (SARS, 2021a:19). Output tax must be levied on taxable supplies, and where section 10(23) is applicable, the output tax declared is nil, however, the vendor may still claim the input tax on expenses incurred in making such a taxable supply (SARS, 2021a:19).

This will be the case with, for example, marketing efforts, including promotional supplies made for no consideration. Input tax deduction can still be claimed when the expenses can be directly attributed to specific taxable supplies made for a consideration, or generally for the promotion of the vendor's other taxable offerings (SARS, 2021a:20). It is furthermore noted that promotional supplies made for no consideration such as a free sample are not regarded as a 'donation', since it is not purely gratuitous as it is supplied with the intention of promoting the vendor's taxable offerings (SARS, 2021a:17).

The aforementioned discussion on the supply of promotional supplies to customers for no consideration can be equated to the supply of a loyalty point in terms of a CLP. This is because, as is evidenced by the terms and conditions of the selected CLPs under section 2.2.3.2, and as noted by Nsakanda *et al.* (2010:707); O'Malley (1998:51); and Sharma and Verma (2014:924) one of the objectives of a CLP is to reward customers for repeatedly purchasing from the business operating the CLP. Therefore, the granting of loyalty points can be seen as a promotional supply to a customer for no consideration, with the purpose of promoting the vendor's other taxable offerings.

Briefly, if a vendor acquired goods or services wholly or partly for the purposes of making taxable supplies, input tax would be claimed in terms of section 16(3). However, if such goods or services are subsequently applied wholly for non-taxable purposes, an output tax adjustment, in terms of section 18(1), must be made in order to essentially reverse the input tax initially claimed. The output tax in terms of section 18(1) is calculated by applying the tax fraction to the open market value of the goods or services. The aforementioned will apply, for example, when goods initially acquired in order to make taxable supplies are subsequently donated, since this represents a change in use from taxable use to wholly non-taxable use. However, no adjustment must be made in respect of expenses incurred in providing promotional products which are given to customers or potential customers in an

effort to market the entity's other taxable offerings (SARS, 2021a:18). This is because the general rule is that a supply made for no consideration by a vendor in respect of a wholly taxable activity or enterprise will be regarded as a taxable supply made in the course or furtherance of an enterprise (SARS, 2021a:19). Consequently, input tax may be claimed in respect of expenses incurred in making such supplies in terms of section 16(3), and output tax will be raised on a value of nil. Moreover, if section 10(23) does not apply, output tax must be raised, per normal rules, on the value of the supply in terms of any other subsection of section 10, or any other provision of the VAT Act which may specifically address it (SARS, 2021a:19). However, this situation will not be further explored, since it is clear that section 10(23) may be applied to CLP rewards granted to CLP members.

One of the promotional offerings highlighted by SARS in Interpretation Note 70 and included in the scope of section 10(23), is a "two for the price of one" type promotion, whereby the customer receives two goods or services, in exchange for consideration equal to the price charged of only one of the goods or services (SARS, 2021a:20). Output tax is effectively levied on the actual consideration received, that is, the consideration for only one of the goods or services (SARS, 2021a:21). This approach is currently followed by Pick n Pay with regards to its Smart Shopper CLP and will be discussed following Example 4, which will be used to explain the VAT treatment of CLP rewards currently applied in South Africa by the most-used CLP of 2021 in South Africa, namely Pick n Pay's Smart Shopper CLP.

#### **Example 4: Current value-added tax treatment of CLP rewards of the most-used CLP of 2021 in South Africa**

*The following example makes reference to "Company C" as it is a fictional example. A factual example will be considered after this example.*

Company C operates a CLP where customers obtain 1 reward point for every R10 spent. Each reward point is worth R1 and points may be used to purchase goods or services from Company C. Customer Z purchases qualifying goods to the value of R100 000 and earns 10 000 CLP points worth R1 each, thus R10 000. The goods were immediately delivered to Customer Z. Company C does not levy output tax on the issue of loyalty points to Customer Z.

Customer Z returns to Company C at a later date, and purchases goods to the amount of R200 000 and decides to redeem the 10 000 CLP points earned worth R10 000. Company C applies the value of the 10 000 loyalty points redeemed as follows:

	<b>ZAR (rounded)</b>
Selling price	200 000
Loyalty points redeemed	(10 000)
<b>Net taxable value</b>	<b>190 000</b>
Value-added tax (R190 000 x 15/115)	24 783

Consequently, output tax is only raised by Company C on the cash consideration received, that is, the original selling price less the value of loyalty points redeemed by the CLP member.

After examining Example 4, it is clear that output tax is never raised on loyalty points issued under CLPs, since output tax is not raised at the point during which the loyalty points are granted to the member, nor upon its redemption. A practical example, considering a receipt from Pick n Pay in which loyalty points were both accrued and redeemed, will now be considered.

**Table 2: Illustration of VAT treatment of CLP rewards currently applied by Pick n Pay**

	<b>ZAR</b>
Selling price relating to standard-rated supplies	298.52
Selling price relating to zero-rated supplies	29.98
<b>Total selling price</b>	<b>328.50</b>
Value of loyalty points redeemed	(16.27)
<b>Consideration payable by customer</b>	<b>312.23</b>
<i>Loyalty points redeemed are applied as follows:</i>	
Value of loyalty points redeemed applied to standard-rated supplies (R16.27 x R298.52/R328.50)	14.79
Value of loyalty points redeemed applied to zero-rated supplies (R16.27 x R29.98/R328.50)	1.48
<b>Value of loyalty points redeemed</b>	<b>16.27</b>

	<b>ZAR</b>
<i>Value-added tax calculated as follows:</i>	
Value-added tax on standard-rated supplies (R298.52 x 15/115)	38.94
Value-added tax on zero-rated supplies (R29.98 x 0/115)	0
Value-added tax on loyalty points redeemed (R16.27 x R298.52/R328.50 x 15/115)	(1.93)
Value-added tax on loyalty points issued (R362.90 / 2 / 100 = R1.81 x nil)	0
<b>Total output tax raised</b> (R298.52 standard-rated supplies incl. VAT – R14.79 loyalty points redeemed against standard-rated supplies incl. VAT) x 15/115)	<b>37.01</b>

Studying the receipt contained in Appendix A on page 76 and the information summarised in Table 2, the following can be deduced. The total value of Smart Shopper points that were redeemed amount to R16.27, of which R14.79 (R16.27 x R298.52 VAT inclusive amount of standard-rated supplies/R328.50 total VAT inclusive amount) was applied to standard-rated supplies, and the remainder applied to zero-rated supplies. VAT of R1.93 is deducted from the total VAT of R38.94, which was calculated as R14.79 x 15/115, resulting in output tax of R37.01 being accounted for. Resultantly, output tax was only raised on the amount after deducting the value of the loyalty points redeemed. Although the highlighted VAT treatment of loyalty points by Pick n Pay addresses the redemption of points, which is outside the scope of this study, this treatment highlights the fact that no output tax is raised on loyalty points by Pick n Pay. This is further evidenced by the fact that in terms of this particular purchase, the customer earned loyalty points to the value of R1.81, of which no output tax was raised either. For Pick n Pay's Smart Shopper CLP, one point is earned for each R2 spent, and each point is valued at R0.01 (Pick n Pay Stores Limited, 2015; Pick n Pay Stores Limited, 2022b). In the aforementioned transaction, the customer's loyalty points earned are calculated on the total invoice value, including VAT, however, excluding the amount of R1.60 spent in respect of carrier bags and excluding 'cash-off' deductions, which results in loyalty points being calculated on an amount of R362.90. The aforementioned is illustrated in Table 2 above.

Therefore, from Appendix A and Table 2 it is evident that Pick n Pay does not raise output tax on loyalty points granted or redeemed, and merely applies the value of loyalty points redeemed to the total selling price payable by the customer. In calculating the value-added tax, it allocates the value of loyalty points redeemed to standard-rated and zero-rated supplies and calculates VAT on standard-rated supplies, based on the amount remaining in respect of such standard-rated supplies after deducting the value of loyalty points attributable to the said standard-rated supplies. Regardless of Pick n Pay's VAT treatment of its Smart Shopper points, it is necessary to consider the treatment proposed by SARS under Interpretation Note 118.

### **3.4. SARS INTERPRETATION NOTE 118**

The VAT treatment of loyalty points granted under a CLP proposed by SARS has been briefly addressed throughout this study. The following paragraphs will summarise the proposed VAT treatment as well as expand on other points raised by SARS in this Interpretation Note.

As noted under section 2.2.1, Interpretation Note 118 only considers the VAT consequences of points-based CLPs, where no additional payment is required to entitle the member to loyalty points and loyalty points can be redeemed and used as payment by members for goods or services.

In Interpretation Note 118, the nature of a loyalty point is such that it represents a right awarded to the member to tender the loyalty points as a method of payment or part-payment for goods or services at a future date and equates a loyalty point to a voucher as envisaged under sections 10(18) and 10(19) of the VAT Act (SARS, 2021b:7-8). Furthermore, awarding future rights to the member constitutes a "supply" as defined in section 1(1) of the VAT Act, since it is performance in terms of a contract, and states that no value is attached to the supply of the loyalty points, since one of the characteristics of a loyalty programme within the ambit of Interpretation Note 118, is that no additional consideration must be required of the member in order to grant loyalty points (SARS, 2021b:12).

Interpretation Note 118 also addresses the sale of a loyalty point, whereby the CLP allows members to purchase additional points, should the loyalty points held by that member be insufficient to be redeemed for goods or services (SARS, 2021b:6). Such loyalty points align themselves with the "commercial substance of a loyalty point as is evidenced by section 63

of the CPA that legislates the consequences of prepaid vouchers, credits, or certificates” (SARS, 2021b:13). Moreover, since the loyalty point generally does not represent a specified goods or service to be supplied, in other words, the nature or character of the goods or services which are purchased using loyalty points are unknown at the point of sale of the loyalty point, the sale of a loyalty point falls within the ambit of section 10(18) (SARS, 2021b:13). Therefore, the supply of the loyalty point, where it is made for a consideration in money, must be disregarded upon the supply of the loyalty point itself, and that the value of the loyalty point forms part of consideration of the goods or services at the time of redemption (SARS, 2021b:13).

In Interpretation Note 118 and as noted above, the commercial substance of a loyalty point is considered to be equivalent to a ‘token, voucher or stamp’ as envisaged under section 10(18) of the VAT Act (SARS, 2021b:8-13). This is important, since it is a common law doctrine that the substance of a transaction or agreement must be considered over its form (Koekemoer, 2021:21). This is because the VAT treatment of the granting of CLP rewards to CLP members should be determined, amongst others, with reference to the commercial substance of a CLP reward or loyalty point. Therefore, guidance may be drawn from a Canadian Goods and Services Tax (GST) court case, where the dissenting judge considered the commercial substance or commercial efficacy of a supply.

### **3.5. SUBSTANCE OVER FORM AND GUIDANCE FROM CANADIAN CASE LAW**

As previously stated, it is a common law doctrine that the substance of a transaction or agreement is considered over its form, and South African tax law is no stranger to this doctrine (Koekemoer, 2021:21). In the context of CLPs, SARS also attempts, in Interpretation Note 118, to focus on the commercial substance of a loyalty point in determining the VAT consequences from the granting of CLP rewards (SARS, 2021b:13). Arguably, SARS has not done this successfully. Therefore, it may be necessary to consider international guidance which applies the ‘substance over form’ doctrine to the VAT (or GST) consequences arising from granting CLP rewards. In this regard, specific reference is made to Canadian GST, which is largely comparable to South African VAT, as both jurisdictions apply similar approaches in taxing the supply of goods or property and services (Geerlings, 2021:35). Furthermore, the legislation governing Canadian GST, namely Excise Tax Act, R.S.C. 1985, c. E-15 (hereinafter referred to as ‘the Canadian Excise Tax Act’) does not specifically address the GST consequences of CLP rewards granted (Geerlings, 2021:10).

Guidance has been issued by the Canada Revenue Agency on the GST treatment of certain loyalty points such as frequent flyer points or air miles collected by employees on their personal credit cards when embarking on business trips (Canada Revenue Agency, 2022). However, the aforementioned guidance is very specific and is thus limited. Consequently, consideration must be made to relevant Canadian case law as discussed below.

### **3.5.1. Canadian Imperial Bank of Canada v Her Majesty the Queen**

In *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021 FCA 96 (A), which represents an appeal case that followed a tax court case, namely *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019 TCC 79. The Federal Court of Appeal of Canada considered a case where the appellant, Canadian Imperial Bank of Canada (CIBC) entered into an agreement with Air Canada, which was subsequently assigned to Aeroplan, in which customers of CIBC could earn Aeroplan Miles when paying with their CIBC credit cards. Resultantly, CIBC represents a loyalty partner, whereas Aeroplan represents the CLP operator, since Aeroplan is responsible for administering the CLP and issuing Aeroplan Miles, and customers transacting with CIBC (using their CIBC credit cards) earn Aeroplan Miles. However, CIBC made payments to Aeroplan in terms of this agreement, and paid Canadian GST. CIBC held the position that it was paying Aeroplan to issue Aeroplan Miles to CIBC customers, and that Aeroplan Miles constituted gift certificates. Section 181.2 of the Canadian Excise Tax Act states that the issuance or sale of gift certificates for a consideration is deemed to not be a supply of property or a service, and that the gift certificate is deemed to be money when redeemed or given as consideration for a supply of property or a service (Canada, 1985). Consequently, CIBC argued that it paid GST erroneously. The court held that the predominant supply made by Aeroplan to CIBC was the supply of promotional and marketing services and not a supply of Aeroplan miles and consequently, was subject to GST.

Section 233 of the Constitution of the Republic of South Africa, states that when interpreting any legislation, every court must prefer any reasonable interpretation of the legislation consistent with international law (South Africa, 1996). Therefore, the aforementioned case, even though it is a Canadian case, is relevant to South African law and the interpretation thereof. Furthermore, the aforementioned case may be considered for the purposes of this study and South African VAT, as Canadian GST is comparable to South African VAT, as

both jurisdictions apply similar rules in determining the taxation arising from the supply of goods or property and services (Geerlings, 2021:35).

*Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021 is relevant for the purposes of this study, as it is one of the few international cases which addresses the tax treatment of CLPs. It is important to note, however, that the case addresses the tax treatment of a payment by a loyalty partner (CIBC) to a CLP operator (Aeroplan), which, when referring to Figure 3, comprises transaction 5, which is outside the scope of this study. However, *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021 made reference to two important principles regarding the tax treatment of CLPs which are relevant for this study. Firstly, loyalty points may constitute 'gift certificates' for GST purposes, which can be equated to a 'token, voucher or stamp' as envisaged under section 10(18) of the VAT Act. This means that the supply of the loyalty point must be disregarded and no output tax must be levied on such supply. Secondly, in order to determine the VAT/GST consequences arising from the issue of a loyalty point, it is important to consider the commercial efficacy or commercial substance of a loyalty point. These principles will be considered below.

#### 3.5.1.1. Gift certificates

Firstly, Webb, JA, delivering the judgment in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021, it was noted that although the Federal Court of Canada did not consider the issue of whether Aeroplan Miles are gift certificates, the Tax Court Judge, Visser J, in the case preceding the aforementioned appeal case, *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019, at 84, held that Aeroplan Miles are not gift certificates and that the supply of Aeroplan Miles to CIBC was part of a single supply of promotional and marketing services by Aeroplan and thus, was subject to GST. 'Gift certificates' is not defined in the Canadian Excise Tax Act, however, in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019 a "gift certificate" with a stated (or electronically retrievable) monetary value is, in essence, "a storage mechanism for money, and must have attributes similar to that of money". Section 181 of the Canadian Excise Tax Act also addresses the GST treatment of "coupons", which is defined to exclude a gift certificate, however, it was not considered whether Aeroplan Miles were instead "coupons" in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019 or 2021 (Canada, 1985).

It is important, however, to consider the Canadian GST treatment of ‘gift certificates’ and ‘coupons’ and how these terms relate to a ‘token, voucher or stamp’ as envisaged in sections 10(18) and 10(19) of the VAT Act (South Africa, 1991). This is because, as discussed under section 3.1, loyalty points can be equated to a ‘token, voucher or stamp’ (SARS, 2021b:7). Since it was held in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019 that Aeroplan Miles are not ‘gift certificates’ for GST purposes, it must be considered whether a ‘gift certificate’ as envisaged under section 181 of the Canadian Excise Tax Act aligns itself with the meaning of a ‘token, voucher or stamp’ under the South African VAT Act, if the Canadian GST treatment of CLPs is borrowed for South African VAT purposes.

In *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019, it was held that ‘gift certificates’ in terms of Canadian GST are “a storage mechanism for money, and must have attributes similar to that of money”. It then follows that these ‘gift certificates’ can be equated to a ‘token, voucher or stamp’ under section 10(18), as such a ‘token, voucher or stamp’ has a monetary value stated on it. Furthermore, the Canadian GST treatment of ‘gift certificates’, under section 181.2 of the Canadian Excise Tax Act, states that the issuance of a gift certificate is deemed to not be a supply, and only once the gift certificate is redeemed, it must be treated as money (Canada, 1985). The treatment of ‘gift certificates’ thus clearly aligns with a ‘token, voucher or stamp’ under section 10(18), where the supply (issuance) of such a token, voucher or stamp is disregarded. Consequently, if it is argued that a ‘gift certificate’ is equivalent to a ‘token, voucher or stamp’ under section 10(18), and a loyalty point is a ‘token, voucher or stamp’ under section 10(18), no South African VAT consequences should arise from the supply of the loyalty point.

#### 3.5.1.2. *Dissenting opinion*

In *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021 at 71 to 92, the Honourable Stratas JA deviated from the judgement of his colleagues. Stratas JA stated, at 72:

“To determine the predominant element of a single multi-element, compound or composite supply, one must identify all of the elements of the supply and ask what element gives the supply its commercial efficacy or which element, in a practical or commercial sense, caused the payment of the consideration: *Global Cash Access (Canada) Inc. v. Canada*, 2013 FCA 269, 451 N.R. 358 at paras. 26-30; *Great-West Life Assurance Company v. Canada*, 2016 FCA 316, [2016] G.S.T.C. 118 at para. 50. In

other words, in a practical, commercial sense, what was the taxpayer really getting out of that part of the deal?"

(Own emphasis)

Stratas JA, at 74, furthermore noted that his colleagues exclusively focused on literal contractual language and states that the disregard of commercial efficacy deviates from legal precedent set by the company's Global Cash and Great-West Life, which encourages one to get to the practical, commercial substance of the supply. As noted, it is a common law doctrine applied in South Africa that the substance of a transaction or agreement is considered over its form (Koekemoer, 2021:21). This approach is supported by *Commissioner for the South African Revenue Service v Respublica (Pty) Ltd*, 2018 SA (A) (81 SATC 175), where a New Zealand GST case, *Rotorua Regional Airport Limited v Commissioner of Inland Revenue*, 2010 24 NZTC 23 was referred to, where it was held:

"[t]he nomenclature used by the parties is not decisive. Nor are the economic or other consequences. What is crucial is the ascertainment of the legal rights and duties which are actually created by the transaction into which the parties entered."

It is important to note, as stated in *Commissioner for the South African Revenue Service v Respublica (Pty) Ltd*, that the New Zealand GST influenced South African VAT. Therefore, it is clear that, when determining the tax consequences from a VAT perspective, the commercial substance of a transaction or agreement must be considered, as opposed to relying on the terminology and contractual language used by the parties at hand. Thus, it remains important to refer to the contractual arrangements under which a supply is made, however, this requires an ascertainment of the legal rights and duties arising from the transaction or agreement, as opposed to relying on the literal contractual language used by the parties, as was held in *Commissioner for the South African Revenue Service v Respublica (Pty) Ltd*.

Stratas, JA, in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021 further determined that the predominant supply arising from the agreement between CIBC and Aeroplan as Aeroplan granting the right to issue Aeroplan Miles to CIBC. This necessitated the consideration of whether Aeroplan Miles are 'gift certificates' or not — consideration which was not made by his colleagues. Stratas JA, in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021, at 87, noted that the Canadian Excise Tax Act does not define

a gift certificate, however, stated that it is “a device, paper or electronic, that may be used, subject to its terms, as full or partial consideration for a supply offered by a supplier” and added that it gives a gift certificate the same quality as money, and is not a consumable property or service. Stratas JA, in the aforementioned case, then concluded that Aeroplan Miles are, indeed, gift certificates.

Stratas JA drew this conclusion and, in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021, at 88, noted that the Tax Court erred in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019, as it found that Aeroplan Miles are not gift certificates, because they do not have a fixed dollar value, which Stratas JA noted is not a requirement in terms of the text, context or purpose of the Canadian Excise Tax Act.

Consequently, judging from the above, if Aeroplan Miles are indeed ‘gift certificates’ as envisaged under section 181 of the Canadian Excise Tax Act, as was held by Stratas JA, and as noted, ‘gift certificates’ in terms of Canadian GST can be equated to a ‘token, voucher or stamp’ under section 10(18) of the South African VAT Act. Based on the aforementioned court case, the granting of a loyalty points must be disregarded upon the supply of the loyalty point to the customer, and the loyalty point must be included in consideration upon the redemption of the loyalty point when the customer purchases goods or services. However, as mentioned, the conclusion that Aeroplan Miles are ‘gift certificates’ was made by a dissenting judge and consequently, this interpretation is not considered Canadian law under the doctrine of legal precedence.

It must also be acknowledged that the preceding discussion revolved around a very specific, isolated case regarding a CLP in the aviation industry. Therefore, it may be beneficial to consider the VAT (or GST) treatment of loyalty points granted under a CLP in another jurisdiction where the treatment is clearer. Following is a discussion regarding the GST treatment of CLP rewards in Australia.

### **3.6. GST TREATMENT OF CLP REWARDS IN AUSTRALIA**

According to Datt, Nienaber and Tran-Nam (2017:339-344), Australian GST is very similar to South African VAT, since both taxes are based on the New Zealand GST model. Therefore, it may be beneficial to consider the Australian GST treatment of CLP rewards.

On 4 April 2012, the Australian Taxation Office issued GSTR 2012/1, which addresses the GST implications of certain loyalty programs (Australian Taxation Office, 2012). A Goods and Services Tax Ruling (GSTR) is issued by the Australian Taxation Office, and is equivalent to a Binding General Ruling in South Africa, whereby the Commissioner of SARS (in the case of a Binding General Ruling) and the Australian Taxation Office (in the case of a Tax Ruling) are bound to the advice contained in such a ruling (Australian Taxation Office, 2019; Koekemoer, 2021:19).

GSTR 2012/1 includes in its scope a CLP that contains the following characteristics (Australian Taxation Office, 2012):

- The LPO issues loyalty points to a member due to the member purchasing qualifying goods or services, or using a credit card to make such a purchase.
- The price paid by the member of the CLP is the same price as for a non-member. This means that the member of the CLP does not pay any additional consideration for the loyalty points.
- The loyalty points granted cannot be transferred or redeemed for money.
- The value of loyalty points earned is low when compared to the price of the underlying goods or services itself (meaning the value would be less than 10% of that of the goods or services), to the extent that the loyalty points have a value for members of the CLP.
- A record-keeping mechanism is in place which allows the LPO, member, or both, to track the accrual of loyalty points.
- The loyalty points may be redeemed in future for a reward, being goods or services, or a right to receive goods or services. The reward itself is dependent on the number of points redeemed by the member, and consequently, the greater the number of points redeemed, the more valuable the reward to the member is likely to be.

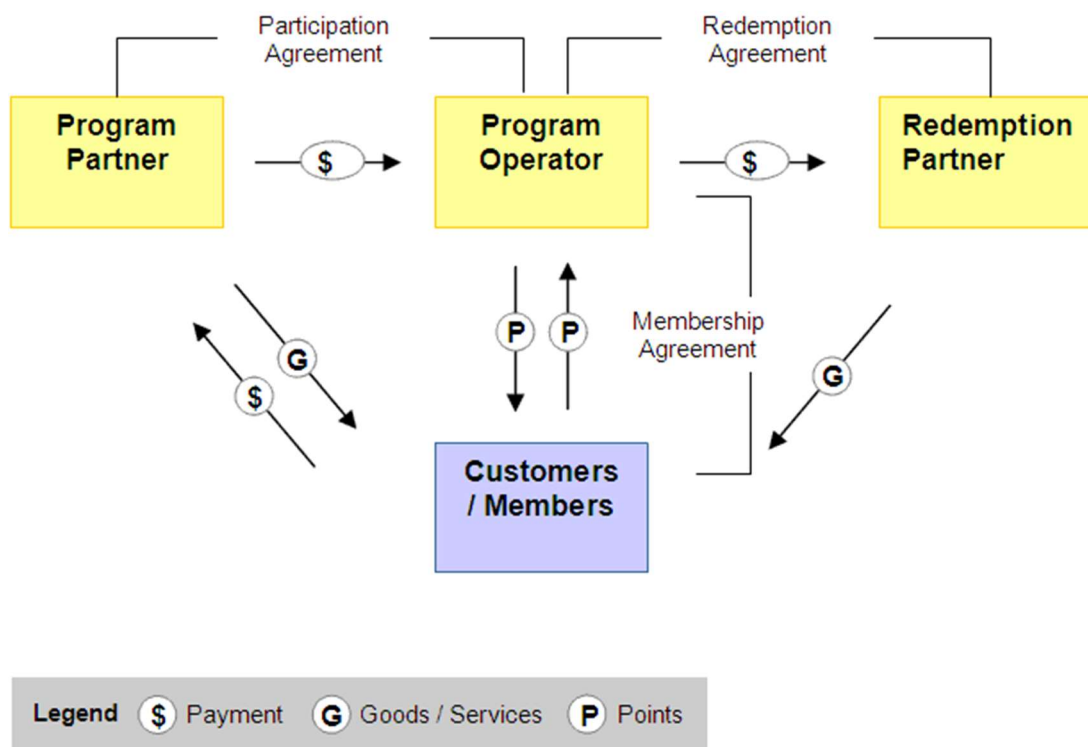
It is worthy to note that GSTR 2012/1 and SARS Interpretation Note 118 address loyalty programmes with arguably the same characteristics, bar certain requirements such as a record-keeping mechanism and the nominal value of loyalty points. Therefore, both GSTR 2012/1 and SARS Interpretation Note 118 address points-based CLPs, whereby the member is at no point required to pay additional consideration in order to receive the benefit of the loyalty points. GSTR 2012/1 defines 'loyalty points' as any record-keeping mechanism which is used to determine the member's eligibility for CLP rewards, however, it does not

include rights to goods or services in the form of vouchers with the meaning ascribed to it in terms of section 100-25 of the Australian Act that legislates GST, namely A New Tax System (Goods and Services Tax) Act, No. 55 of 1999 (the Australian GST Act).

Section 100-25 of the Australian GST Act defines a 'voucher' as "any voucher, token, stamp, coupon or similar article, or prepaid phone card or facility, the redemption of which in accordance with its terms entitles the holder to receive supplies in accordance with its terms" (Australia, 1999). This definition is strikingly similar to a 'token, voucher or stamp' as envisaged under sections 10(18), 10(19) and 10(20) of the VAT Act. However, sections 100-1 and 100-5 of the Australian GST Act state that the supply of a voucher with a stated monetary value is not subject to GST, if upon redemption, the holder is entitled to supplies up to the monetary value stated on such a voucher and the consideration for the voucher does not exceed the monetary value stated (Australia, 1999). This treatment of a voucher with a stated monetary value is the same as the treatment of a 'token, voucher or stamp' under section 10(18) of the VAT Act, whereby the supply of a 'token, voucher or stamp' with a monetary value stated, for a consideration in money, is also disregarded for South African VAT purposes, except to the extent that the consideration exceeds the monetary value stated (South Africa, 1991). In accordance with section 100-12 of the Australian GST Act, the consideration for a taxable supply includes the stated monetary value of a voucher. For South African VAT purposes, the treatment is the same in that the monetary value of a 'token, voucher or stamp' is included in consideration for the supply of goods or services upon redemption of such 'token, voucher or stamp' (Stiglingh, 2021). Despite the similarity, GSTR 2012/1 excludes CLP rewards that meet the definition of a 'voucher' in section 100-25 of the Australian GST Act.

GSTR 2012/1 furthermore provides a basic structure of a multi-party CLP as illustrated in Figure 4 below.

**Figure 4: Basic structure of a multi-party CLP**  
**Basic Structure of a Multi-Party Loyalty Program**



Source: Australian Taxation Office (2012)

The illustration provided in Figure 4 is similar to the illustration provided by SARS in Interpretation Note 118, as indicated in Figure 3 in section 2.2.2.

GSTR 2012/1 is very clear in its interpretation of the granting of loyalty points to a member of a CLP, and paragraph 16 of GSTR 2012/1 reads:

“When a member pays consideration for goods or services and gets points allocated to them in consequence, the member's payment is consideration for the supply of the goods or services they acquire. There should not be an apportionment of the amount paid by the member between the goods or services and the points” (Australian Taxation Office, 2012).

(Own emphasis)

Therefore, GSTR 2012/1 clearly states that the consideration paid by the member for goods or services is exclusively paid for said goods or services and should not be attributed, even on a pro-rata basis, to the loyalty points granted to the member of the CLP. Furthermore,

and although not within the scope of this study, GSTR 2012/1 differs from SARS Interpretation Note 118 in that the redemption of loyalty points under GSTR 2012/1 is not regarded as consideration for the supply of goods or services subsequently purchased, whereas Interpretation Note 118 regards the loyalty points as consideration for goods or services upon its redemption (Australian Taxation Office, 2012; SARS, 2021b:17).

GSTR 2012/1 furthermore provides an example, namely Example one, to illustrate the aforementioned. This example has been adapted for Example 5 below.

### **Example 5: GSTR 2012/1 – No GST on loyalty points**

Harry is a member of a loyalty programme which complies with the characteristics of a CLP that is included in the scope of GSTR 2012/1, as aforementioned. Harry purchases clothing at a large retail store which is a 'program partner' (equivalent to a loyalty partner in SARS Interpretation Note 118) of the aforementioned CLP.

Harry pays AU\$110 for the clothing and swipes his CLP membership card, which results in an allocation of 20 loyalty points in respect of the CLP.

The only taxable supply made to Harry is the supply of clothing, on which GST of AU\$10 was raised. None of the AU\$110 paid by Harry is consideration for the loyalty points granted to Harry.

Harry subsequently purchases other qualifying goods and services which earned him loyalty points in respect of the CLP to which he belongs. At a certain point in time, Harry accrued enough loyalty points in respect of this CLP to redeem his loyalty points for a bus ticket.

The redemption of loyalty points is not consideration for the supply of a bus ticket.

Source: Adapted from Australian Taxation Office (2012)

Consequently, it is clear that for Australian GST purposes, GST is not raised on the supply of loyalty points.

### **3.7. CONCLUSION**

This chapter discussed the South African VAT treatment of granting CLP rewards to customers. It was revealed that the granting of a CLP reward or loyalty point to a CLP

member meets the requirements of the charging section, namely section 7(1)(a) of the VAT Act. This chapter furthermore considered specific legislative provisions that may be applicable to CLPs, namely sections 10(18), 10(19), and 10(23), along with relevant case law. It was found that a loyalty point can be equated to a 'token, voucher or stamp' as envisaged under section 10(18), 10(19), and 10(20), and that section 10(18) may find its application to loyalty points, if it is supplied for a consideration in money (which is an issue in its own right and was addressed in Chapter 2). This means that the supply of a loyalty point by the CLP operator to the CLP member for a consideration in money must be disregarded and consequently, no output tax is raised on such a supply. A supply made for no consideration, which is addressed under section 10(23) of the VAT Act, was also considered against the supply of a loyalty point to a CLP member. In this regard, it was established that the granting of a loyalty point is similar to the supply by a vendor of promotional offerings, on which a vendor may claim input tax, however, output tax is levied on a nil value, in accordance with section 10(23).

Moreover, Chapter 3 discussed SARS's proposed treatment, outlined in SARS Interpretation Note 118, of the granting of CLP rewards to CLP members. SARS contends that the supply of a loyalty point is made for no consideration, and consequently, no value can be attached to such supply. It is furthermore suggested that the nature of a loyalty point is such that the specific goods or services purchased using loyalty points are unknown at the point of sale of the loyalty point, and consequently, section 10(18) should apply as opposed to section 10(19) (SARS, 2021b:13). Chapter 3 also considered the commercial substance of a loyalty point, and in this regard, guidance was drawn from a Canadian GST case, namely *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021, in which a dissenting judge argued that loyalty points can be considered to be a 'gift certificate', which is equivalent to a 'token, voucher or stamp' under the South African VAT Act. Due to the Canadian court case being an isolated case and the aforesaid opinion being raised by a dissenting judge and not the quorum, the Australian GST treatment of CLP rewards granted was also studied. The Australian Taxation Office issued a tax ruling, equivalent to a South African Binding General Ruling issued by SARS, which held that no consideration is paid by a CLP member in respect of a loyalty point received and that the consideration paid by such member for the goods or services acquired must not be allocated between the original goods or services acquired and loyalty points granted (Australian Taxation Office, 2012). Chapter 4 will provide a summary of research findings and conclude on this study.

## **CHAPTER 4: CONCLUSION**

### **4.1. INTRODUCTION**

As discussed in Chapter 1, the VAT treatment of the granting of CLP rewards to CLP members is predominantly unclear, due to differing opinions and limited guidance on this matter. In view of this issue, the present study aims to critically review the main arguments held, both in South Africa and in limited jurisdictions abroad, with regard to the VAT taxability of CLP rewards granted. Consequently, this study set out to achieve the following research objectives:

- Define the characteristics of a CLP for the purposes of this study that would result in rewards potentially being subject to tax under the South African VAT system.
- Critically review the main arguments addressed in current literature regarding the VAT treatment of CLP rewards in South Africa.
- Consider current international literature relating to the taxability of CLP rewards in terms of taxes in other jurisdictions that are comparable to South African VAT.

In order to achieve the research objectives, a doctrinal research methodology was followed, which included of reform-oriented research. Although specific recommendations for amendments to legislation were not made, this study remains reform-oriented, since it investigates the appropriateness of underlying doctrines of South African VAT when considering it against the granting of CLP rewards to customers.

### **4.2. SUMMARY OF FINDINGS AND CONCLUSION**

As stated, the first research objective of this study was to define the characteristics of a CLP for the purposes of this study that will result in CLP rewards potentially being subject to South African VAT. This objective was achieved by referring to definitions provided by various researchers as well as the CPA and SARS Interpretation Note 118. Resultantly, a CLP is defined for the purposes of this study as a points-based CLP in which only two parties are present, namely the CLP member and CLP operator, who acts in the role of CLP operator, loyalty partner, and redemption partner. Consequently, CLPs in which upfront discounts are provided, are excluded from the definition of a CLP for the purposes of this study.

The second research objective comprised a critical review of the main arguments in current literature regarding the VAT taxability of granting CLP rewards. This objective was achieved and laid out in Chapters 2 and 3 of this study, which provided an analysis of relevant literature pertaining to the VAT taxability of CLP rewards granted. This study, consequently, revealed that there are three main schools of thought when considering the VAT treatment of granting CLP rewards to CLP members. The first school of thought supposes that the customer participating in a CLP receives CLP rewards free of charge which is an approach followed by SARS. The second school of thought is of the opinion that the consideration paid for the underlying goods or services purchased must be allocated to both the goods or services purchased as well as the CLP rewards granted. This means that the customer is indeed providing consideration for CLP rewards, however, this consideration is included in the selling price of the goods or services in respect of which the CLP rewards are granted. This perspective is taken by IFRS in respect of the accounting treatment of CLP rewards. The third and final school of thought, however, suggests that the customer provides consideration for CLP rewards in the form of customer information.

The third research objective was to consider relevant international literature relating to the taxability of CLP rewards in other jurisdictions that apply a tax similar to South African VAT. In accomplishing this objective, Canadian and Australian GST were considered and were found to be similar to South African VAT. In respect of Canadian GST, this study considered a case that appeared before the Federal Court of Appeal of Canada in which a dissenting judge found that CLP rewards are comparable to 'gift certificates', which, when compared to South African VAT, is equivalent to a 'token, voucher or stamp'. The implication of the aforementioned finding is that, if a loyalty point is indeed a 'gift certificate' as defined, then the supply of such a loyalty point is disregarded and consequently, no GST is raised. However, the guidance provided in the Canadian GST case is limited, as it is based on a dissenting opinion and this specific case dealt with a very specific instance, namely CLP rewards issued in the aviation industry. Therefore, this study also considered guidance from Australia, since the Australian Taxation Office is very clear on its stance regarding the GST consequences arising from granting CLP rewards. In terms of GSTR 2012/1 which is the equivalent of a Binding General Ruling issued by SARS, the supply of a loyalty point is made for no consideration and no portion of the consideration paid by the CLP member for the underlying goods and services must be allocated to loyalty points issued. Consequently, as with Canadian GST, no Australian GST must be raised in respect of the granting of CLP

rewards to CLP members. Table 3 below, provides a comparison of VAT/GST treatment of CLP rewards granted in each of the aforementioned jurisdictions, namely South Africa, Canada, and Australia.

**Table 3: Comparison of VAT/GST treatment of CLP rewards granted**

	South Africa	Canada	Australia
Comparability to South African VAT provisions	-	✓	✓
Specific legislative provisions addressing VAT/GST consequences of granting CLP rewards	x	x	x
Wording in legislative provisions which may be attributed to CLP rewards	'token, voucher or stamp'	'gift certificate' <sup>1</sup>	'voucher' <sup>2</sup>
Other official guidance issued	✓	✓ (limited)	✓
Suggested approach in official guidance for CLP rewards granted	Granted for no consideration, thus no VAT levied	Guidance does not specifically address GST treatment	Granted for no consideration, thus no GST levied
Applies IFRS 15	✓	✓	✓

Source: Adapted from Geerlings (2021:10, 32)

When considering the findings of this study, it is evident that commentators are inclined towards the notion that CLP rewards are indeed granted free of charge and that no output tax should be raised on the granting of CLP rewards to CLP members.

<sup>1</sup> Suggested by Canadian Tax Court in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2019 and dissenting judge in *Canadian Imperial Bank of Canada v Her Majesty the Queen*, 2021.

<sup>2</sup> GSTR 2012/1 excludes from its scope loyalty points which meet the definition of a 'voucher' in section 100-25 of the Australian GST Act, although CLP rewards may fall within the scope of this definition.

### **4.3. LIMITATIONS**

As laid out under section 1.7 of Chapter 1, this study focuses only on an 'exclusive programme', which is a CLP in which only two members are participants, namely the CLP member and the CLP operator who acts in the roles of CLP operator, loyalty partner, and redemption partner. Furthermore, this study only focused on points-based CLPs. Lastly, the present study limited its consideration of international guidance to Canada and Australia.

### **4.4. FUTURE RESEARCH**

The following areas have been identified for further research:

- A study that aims to establish the South African VAT consequences arising from a multi-party programme, in other words, a CLP in which there are four participants, as indicated in Figure 3 on page 16 and Figure 4 on page 56. This study could include consideration of the VAT consequences for each of the four parties to the CLP. This would provide guidance to businesses implementing and participating in CLPs on how to account for VAT, if at all.
- The South African VAT treatment of CLP rewards granted, where CLP rewards constitute a reward other than loyalty points could be studied, for example, upfront or personalised discounts or tiered loyalty programmes, amongst others.
- A study considering other jurisdictions' VAT (or equivalent) treatment of CLP rewards, and how this compares to the proposed South African VAT treatment.

### **4.5. CONCLUDING REMARKS**

This study found that, although there are differing opinions and limited legal guidance on the South African VAT treatment of the granting of CLP rewards, commentators are inclined towards not raising VAT (or GST) on the granting of CLP rewards. This is because the relevant literature supporting the aforementioned argument suggests that CLP members do not pay consideration at all for CLP rewards. Regardless of the aforementioned inclination, this study found two additional arguments to the contention that CLP rewards are granted free of charge. IFRS 15, which prescribes the accounting treatment of CLP rewards, is in direct antithesis of the notion that CLP rewards are granted for no consideration, as it requires entities to allocate the total transaction price paid by the CLP member to the underlying goods and services purchased, and the CLP rewards granted. It is essential to note that IFRS is applied in at least 167 jurisdictions worldwide (IFRS Foundation, 2022).

The final argument proposes that CLP members pay for CLP rewards in the form of customer information. This argument is supported by the objectives of a CLP as determined by this study as well as when analysing the terms and conditions of the three most-used CLPs of 2021 in South Africa. In conclusion, even though uncertainty regarding the VAT treatment of CLP rewards granted to CLP members remains, it is evident that current literature indicates that CLP rewards are indeed granted for no consideration and consequently, no VAT should be raised on the granting of CLP rewards.

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**APPENDIX A:**  
**Demonstration of Pick n Pay Limited's VAT treatment of loyalty points under  
its Smart Shopper CLP**



\*\*\*\*\*ELECTRONIC TAX INVOICE\*\*\*\*\*

HILLCREST  
087 750 2120 /2119

CASHIER: prudence mbeba

██████████  
3 @ 16.99 50.97  
██████████  
2 @ 33.99 67.98  
██████████ 88.99  
\*\* Less cash-off -26.00  
██████████ 79.99  
██████████ 34.99  
██████████  
2 @ 19.99 39.98#V  
\*\* Less cash-off -10.00  
██████████  
2 @ 0.80 1.60  
██████████ 20.00  
Smart Shopper Instant Saving -20.00  
DUE VAT INCL 328.50

-----DISCOUNT-----  
SMART SHOPPER REDEMPTION 16.27  
VAT INCL. OF 1.93  
-----TENDER-----  
312.23  
Visa Card 312.23  
004332  
TOTAL ITEMS: 13  
-----TAX INVOICE-----  
TAXABLE GROSS S/SHOPPER NET  
VAL VAT VAL DISC VAT VAL VAT VAL  
298.52 38.94 -1.93 37.01  
# 29.98 0.00 0.00 0.00  
# ZERO RATED  
e NON-SUPPLY

-----VAT REG NO. 4090105588-----  
V VITALITY HEALTHYFOOD CASH BACK ITEM

Liquor Lic.:GAU/201198C  
PLEASE RETAIN AS YOUR GUARANTEE  
CUSTOMER CARE LINE: 0860 30 30 30  
WEBSITE: www.picknpay.co.za  
THANK YOU FOR SHOPPING WITH US.

-----SMART SHOPPER-----  
Smart Shopper card # \*\*\*\*\*3268  
Rands earned: R1.81  
Rands used: R16.27  
Total Loyalty Savings: R20.00

**APPENDIX B:**  
**Declaration of plagiarism**



## DEPARTMENT OF TAXATION

### Declaration Regarding Plagiarism

The Department of Taxation emphasises integrity and ethical behaviour with regard to the preparation of all written assignments. Although the lecturer will provide you with information regarding reference techniques, as well as ways to avoid plagiarism (see the "Guidelines on Referencing" document), you also have a responsibility to fulfil in this regard. Should you at any time feel unsure about the requirements, you must consult the lecturer concerned before submitting an assignment.

You are guilty of plagiarism when you extract information from a book, article, web page or any other information source without acknowledging the source and pretend that it is your own work. This does not only apply to cases where you quote the source directly, but also when you present someone else's work in a somewhat amended (paraphrased) format or when you use someone else's arguments or ideas without the necessary acknowledgement. You are also guilty of plagiarism if you copy and paste information directly from an electronic source (e.g., a web site, e-mail message, electronic journal article or CD-ROM) without paraphrasing it or placing it in quotation marks, even if you acknowledge the source.

You are not allowed to submit another student's previous work as your own. You are furthermore not allowed to let anyone copy or use your work with the intention of presenting it as his/her own.

Students who are guilty of plagiarism will forfeit all credits for the work concerned. In addition, the matter will be referred to the Committee for Discipline (Students) for a ruling. Plagiarism is considered a serious violation of the University's regulations and may lead to your suspension from the University. The University's policy regarding plagiarism is available on the Internet at <http://www.library.up.ac.za/plagiarism/index.htm>.

For the period that you are a student at the Department of Taxation, the following declaration must accompany all written work that is submitted for evaluation. No written work will be accepted unless the declaration has been completed and is included in the particular assignment.

	Student
I (full names & surname):	Trevor Jason Hill
Student number:	17038822

#### Declare the following:

1. I understand what plagiarism entails and am aware of the University's policy in this regard.
2. I declare that this assignment is my own, original work. Where someone else's work was used (whether from a printed source, the Internet or any other source) due acknowledgement was given and reference was made according to departmental requirements.
3. I did not copy and paste any information directly from an electronic source (e.g., a web page, electronic journal article or CD ROM) into this document.
4. I did not make use of another student's previous work and submitted it as my own.
5. I did not allow and will not allow anyone to copy my work with the intention of presenting it as his/her own work.

Signature