

**DISCUSSION PAPER ON THE VAT
TREATMENT OF LOYALTY PROGRAMMES**

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Preamble

In this discussion paper unless the context indicates otherwise –

- “**customer**” means any person who buys goods or services from a vendor;
- “**loyalty partner**” means the vendor selling eligible goods or services to a member on which loyalty points are earned by the said member;
- “**loyalty programme**” means a loyalty programme, reward scheme or any other similar scheme or programme;
- “**loyalty points**” include miles, loyalty card points or any other similar items which are allocated to a customer and can be redeemed in future by such customer for a reward, but excludes any item that satisfies the definition of a “voucher”, “token” or “stamp”.
- “**LPO**” means the Loyalty Programme Operator (that is, the administrator of the loyalty programme);
- “**member**” means a customer who is a participant in a loyalty programme;
- “**redemption partner**” means the vendor responsible for making supplies of goods or services to the member in exchange for loyalty points;
- “**relevant parties to a loyalty programme**” means any participant in a loyalty programme and includes the member, LPO, loyalty partner and the redemption partner;
- “**section**” means a section of the VAT Act;
- “**stakeholders**” mean the relevant parties in a loyalty programme excluding the member;
- “**VAT Act**” means the Value-Added Tax Act No. 89 of 1991; and
- any word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

Loyalty programmes are incentive schemes used by businesses such as retailers or banks to encourage sales by offering rewards with the intention of attracting new customers as well as retaining their respective customer bases. Businesses also use the information gathered throughout this process to identify trends in customer spending and maximise efficiency in their stock management systems.

There is a range of different loyalty programmes currently available in the South African market. It recently came to SARS’s attention that stakeholders operating loyalty programmes interpret and apply the relevant provisions in the VAT Act differently.

In light of the above, the proposals contained in this document are intended to promote discussion between SARS and stakeholders with a view to –

- identify and understand the current difficulties experienced, if any, in applying the provisions of the VAT Act;
- identify areas in the VAT Act which may require amendments to address the difficulties identified, if any; and

- adopt a policy which will result in the consistent application of VAT principles for all loyalty programmes.

You are invited to send your comments regarding this Discussion Paper to policycomments@sars.gov.za on or before 31 May 2014. Due to time constraints it will not be possible to respond individually to comments received.

2. Introduction

SARS Legal and Policy Division: Interpretation and Rulings - Indirect Tax (ITP) conducted research on the different types of loyalty programmes currently available in South Africa. During this research process, certain loyalty programmes were identified which best represented the different structures of loyalty programmes currently available. During July 2013, discussions were held with stakeholders with the intention of gaining an in-depth understanding of the business activities associated with different structures and types of loyalty programmes.

As a result of the above, it became apparent that it is not possible to discuss each type of loyalty programme currently available in the South African market in one document. The purpose of this document is therefore to adopt VAT principles that can be applied to a loyalty programme of any nature.

This document –

- serves as a discussion document and provides details of loyalty programmes in general, the relevant VAT principles applicable thereto as well as any proposed amendments in respect thereof;
- does not address the VAT treatment of loyalty points which complies with the definition of a “voucher”, “token” or “stamp” [as envisaged in section 10(18), (19) or (20)];
- does not address the VAT consequences of loyalty points awarded to employees as an incentive (falling within the provisions of the Seventh Schedule to the Income Tax Act¹); and
- does not deal with the VAT principles applicable to any other benefits or discounts offered to members as a result of their membership to a specific loyalty programme (for example, discounts on certain products or the use of a lounge at an airport).

3. Characteristics of loyalty programmes

Section 1 of the Consumer Protection Act² (the CPA), defines a “loyalty programme” as –

“any arrangement or scheme in the ordinary course of business, in terms of which a supplier of goods or services, 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”.

¹ Act No. 58 of 1962.

² Act No. 68 of 2008, section 1.

Based on the above as well as the information obtained from the relevant stakeholders operating the loyalty programmes, a loyalty programme for the purposes of this document will include any incentive programme with all the following characteristics:

- Membership to a loyalty programme is not limited to a specific group of people; any customer of an entity or group of entities will be allowed to apply for such membership;
- Members are allocated an award, usually in the form of loyalty points, based on the value of goods or services acquired from certain entities (the original supply) or for the use of a specific type of card;³;
- The member is not responsible for any additional payment or consideration before the loyalty points are allocated to the said member (excluding the membership fee where applicable);
- Each loyalty point allocated has a value attached to it, whether specific or notional;
- All customers pay the same price for goods and services acquired, whether they are members of the loyalty programme or not. This does not include any additional benefits to which a customer is entitled to as a result of its membership to a specific loyalty programme;
- The value of the loyalty points allocated is generally small in relation to the original supply of goods or services on which the loyalty points are earned;
- The loyalty points can be redeemed by the member in exchange for goods or services⁴ of a similar value (that is, the value of the goods or services acquired must be similar to the fair value of the loyalty points used as payment for the said goods or services), whether supplied through one or a variety of entities; and
- The only income derived by the LPO from the loyalty programme consists of management fees charged. The LPO does not make a profit on the actual loyalty points allocated and subsequently redeemed by the member, that is the redemption cost paid by the LPO to the redemption partner when loyalty points are redeemed by the member is equal to the points fee originally charged by the LPO to the loyalty partner (refer to **3.3.2**).

3.1 Nature and characteristics of a loyalty point

Loyalty points are allocated to members based on goods or services purchased and can be used as payment (or part payment) for goods or services based on the value of the loyalty points redeemed.

A loyalty credit or award is defined in section 1 of the CPA to be any –

- “(a) benefit accruing to a 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

³ “Card” refers to a card linked with a loyalty programme which is usually swiped before the purchase and can include a bank card used to pay for the goods and services acquired.

⁴ Certain loyalty programmes allow members to redeem points for money which is usually paid into a bank account. This document includes these loyalty programmes.

assert a claim for any goods, services or other benefit, allocated to a 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”.

A loyalty point in itself has no commercial value; it cannot be sold by the member for a specific amount or consideration. The loyalty point however creates an expectation that it can be used as payment for a future supply of goods or services. In some instances, loyalty programmes require the member to accumulate a certain amount of loyalty points before it can be redeemed for a reward.

Loyalty points are usually electronic units allocated to members that may be evidenced electronically or on printed matter where the balance or transaction is indicated on, for instance a statement or invoice. In some instances a member is issued with a voucher to indicate the value of the reward to which the member is entitled.

Although a loyalty point does not fully comply with the definition of a “voucher”⁵, both a loyalty point and a voucher represent a right to the holder thereof to claim a certain reward, whether in money or otherwise. As a result, the LPO has a responsibility (liability) towards the member to provide the reward, whether on its own or through a redemption partner.

3.2 Loyalty programme structures

As previously indicated, there is currently a wide range of loyalty programmes available in the South African market. The differences in the structure of loyalty programmes mostly result from the –

- industry wherein it operates;
- nature of the programme; and
- role of each of the relevant stakeholders to the said programme.

During the research process, two main types of loyalty programmes were identified:

- (i) The exclusive programme; and
- (ii) The multiple party programme.

The loyalty programmes currently operating in the South African market contain different variations of these two types or programme structures. Each stakeholder must therefore identify its role within the loyalty programme to determine the transactions relevant to it.

3.3 Transactions and parties to a loyalty programme

The relevant parties to a loyalty programme will depend on the nature as well as the structure of the said programme.

⁵ The Oxford Dictionary Online (<http://oxforddictionaries.com/definition/english/voucher?q=voucher>, accessed: 2012-12-14) defines a voucher as “a small printed piece of paper that entitles the holder to a discount, or that may be exchanged for goods or services”.

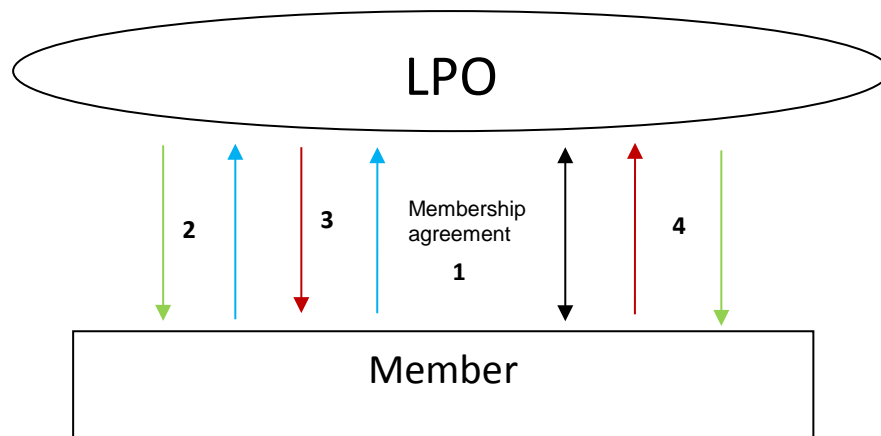
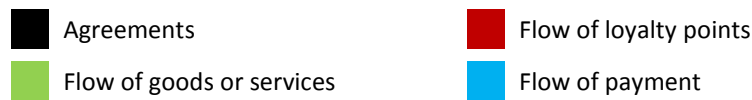
3.3.1 The exclusive programme

This refers to a loyalty programme which is usually administered in-house where the relevant entity (the LPO) acts as the only stakeholder to the loyalty programme. It is the responsibility of the LPO to keep record of the loyalty points earned and subsequently redeemed by each member.

A customer becomes a member of the loyalty programme by entering into an agreement with the LPO. For purposes of this discussion document, this agreement will be referred to as the Membership Agreement.

Loyalty points may be earned on specific goods or services acquired from the LPO (eligible purchases) usually as a result of the member being in possession of a card verifying its membership to the specific loyalty programme. The member may then redeem these loyalty points by offering the said points as payment (or part payment) for acquisitions of goods or services at the LPO.

A simple diagram illustrating the flow of transactions within an **exclusive programme** is set out below:



Transaction 1 – The member may in certain instances be required to pay a membership fee to the LPO in order to participate in the specific loyalty programme (refer to **4.1**).

Transaction 2 – The member makes eligible purchases at the LPO (refer to **4.2**).

Transaction 3 – The LPO is responsible for the allocation of loyalty points to the member based on the eligible purchases made by the said member (refer to **4.2**).

Certain loyalty programmes allow members to purchase additional loyalty points where the value of the loyalty points held by the member is insufficient to be redeemed for certain goods or services (refer to **4.6**).

Transaction 4 – The member redeems the loyalty points by offering the loyalty points as payment (or part payment) for the acquisition of goods or services supplied by the LPO (refer to **4.4**).

3.3.2 The multiple party programme

A multiple party programme is more complex as a result of the fact that there are more entities involved in the programme. The loyalty programme can either be managed by a separate entity or a stakeholder to the programme (the LPO). It is the responsibility of the LPO to keep record of the loyalty points earned and subsequently redeemed by each member.

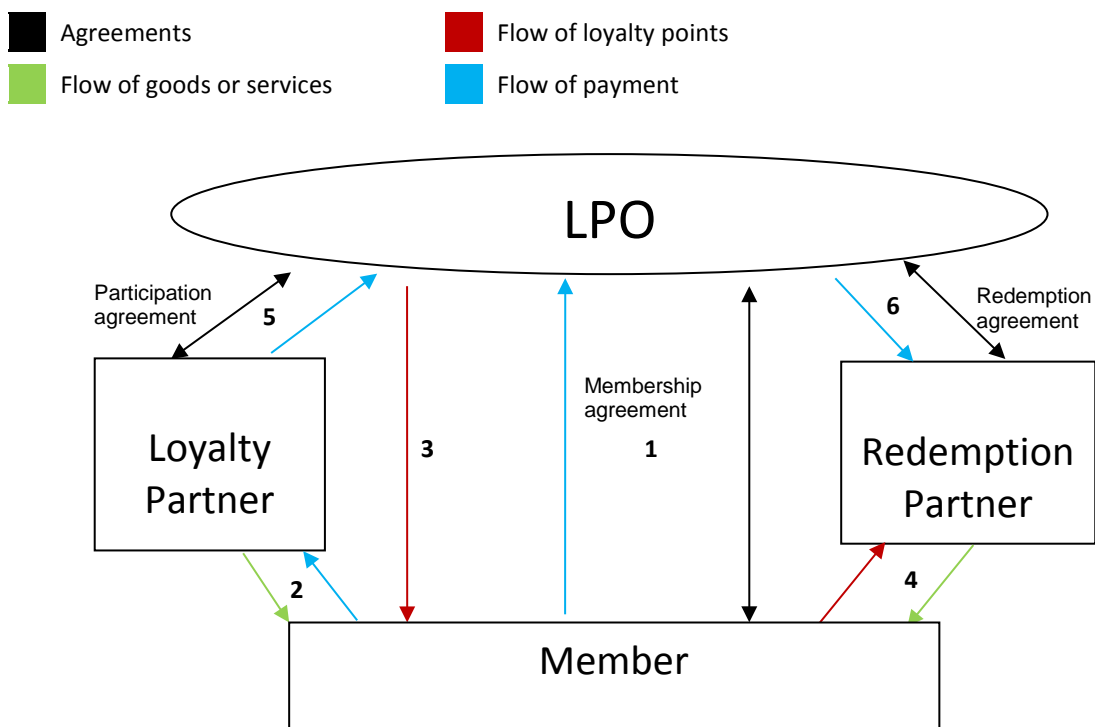
A customer becomes a member of the loyalty programme by entering into a Membership Agreement with the LPO.

Various other entities can become partners to the loyalty programme. The roles and responsibilities of each partner are set out in an agreement between the LPO and the specific partner.

The member will be entitled to loyalty points based on eligible purchases made from a partner (the loyalty partner) in the loyalty programme. The relationship between the LPO and the loyalty partner is generally governed by an agreement which will be referred to as the Participation Agreement.

The member will then be entitled to redeem the loyalty points earned by offering the loyalty points as payment (or part payment) for future purchases from another partner (the redemption partner) to the loyalty programme. The relationship between the LPO and the redemption partner is generally governed by an agreement which will be referred to as the Redemption Agreement.

A typical structure of a loyalty programme involving **multiple parties** can be illustrated as follows:⁶



Transaction 1 – The member may in certain instances be required to pay a membership fee in order to participate in the specific loyalty programme (refer to 4.1).

⁶ The transaction numbers are not in sequential order as they follow the flow of the transactions in the relevant diagram.

Transaction 2 – The member makes eligible purchases from the loyalty partner or swipes a card at the loyalty partner entitling the member to loyalty points on the acquisition of the relevant goods and/or services (refer to **4.2**).

Transaction 3 – The LPO is responsible for allocating loyalty points to the member based on the member's purchases at the loyalty partner (refer to **4.2**).

Certain loyalty programmes allow members to purchase additional loyalty points where the value of the loyalty points held by the member is insufficient to be redeemed for certain goods or services (refer to **4.6**).

Transaction 5 – Transactions that occur between the loyalty partner and the LPO may include the following (refer to **4.3**):

- The loyalty partner pays the LPO a management or administration fee, whether weekly, monthly or annually, for the management of the loyalty programme;
- The loyalty partner pays the LPO an amount equal to the value of the loyalty points allocated to members as a result of the said members' purchases at the loyalty partner (points fee).

Transaction 4 – The member redeems the loyalty points by offering it as payment (or part payment) for the acquisition of goods or services at the redemption partner (refer to **4.4**).

Transaction 6 – Transactions that occur between the redemption partner and the LPO may include the following (refer to **4.5**):

- The redemption partner pays the LPO a management or administration fee, whether weekly, monthly or annually, for the management of the loyalty programme;
- The LPO pays the redemption partner an amount equal to the value of the loyalty points accepted as payment for the supply of goods or services (redemption cost).

This document will focus on the transactions of a multiple party programme. The VAT principles and application thereof will however apply equally to transactions occurring within an exclusive programme, unless indicated otherwise.

4. Interpretation of current legislation and proposed position

In light of the fact that there are no specific provisions in the VAT Act that regulate the VAT treatment of transactions within a loyalty programme, the normal VAT principles will be applied. Proposals are made to address any difficulties that are identified in the application of current VAT legislation. These proposals are for purposes of soliciting comments from the relevant stakeholders and may not necessarily result in an amendment to the VAT Act.

The discussions set out in **4.1** to **4.5** below relates to the VAT treatment of transactions where loyalty points are allocated to a member by the LPO as a result of eligible purchases made by the member at a loyalty partner. Paragraph **4.6** sets out the differences in the VAT treatment of certain transactions where the member purchased the loyalty points from the LPO.

4.1 Membership fee

Output tax

LPO

In certain instances, the member is required to pay an annual/monthly/weekly fee to obtain the right to participate in the loyalty programme (refer to Transaction 1 in the diagrams in **3.3**).

The membership fee is generally governed by the Membership Agreement between the LPO and the member and results from the member being granted the right to participate in, and obtain the benefits of the loyalty programme. The granting of a right to participate in the loyalty programme falls within the ambit of the definition of the term “services” in section 1(1). As a result, the supply of this service by the LPO to the member will be subject to VAT at the standard rate of 14%⁷ under section 7(1)(a).

Input tax

LPO

The goods or services acquired for the purpose of earning the membership fee (that is, making a taxable supply) will be subject to the general provisions governing input tax. These provisions allow the VAT incurred on the acquisition of goods or services to be deducted as input tax to the extent that –

- the said goods or services were acquired for the purpose of making taxable supplies; and
- the requirements contained in sections 16(2) and (3) have been met.

Member

The VAT incurred on the membership fee by the member is subject to the general provisions governing input tax (as discussed above).

Example 1 – The VAT implications on the membership fee charged by the LPO

Facts:

Member A pays the LPO R150 per month (inclusive of VAT of R18,42) for the right to participate in the loyalty programme.

Result:

The LPO will be liable, in respect of the supply of “services” to Member A, to –

- issue a tax invoice in accordance with section 20; and
- declare output tax of R18,42 on the earlier of the date of payment or the date the LPO issues an invoice in respect of the membership fee.

The VAT incurred of R18,42 by the member may be deducted as input tax subject to the general provisions governing input tax.

⁷ Unless the zero-rating provisions of section 11 apply to the transaction.

4.2 Original supply of goods or services

Output tax

Loyalty partner

Before loyalty points can be awarded to a member, the member must acquire eligible goods or services from the loyalty partner (refer to Transaction 2 in the diagrams in **3.3**). The supply of these goods or services by the loyalty partner (the original supply) will be subject to the normal provisions of the VAT Act and will be taxed in accordance with section 7(1)(a) subject to the zero-rating or exemptions contained in sections 11 and 12 respectively.

Value of the original supply

According to section 10(2), read with section 10(3), the value of the supply of goods or services is equal to the consideration received for such supply unless otherwise provided for in the VAT Act. The definition of a “consideration” in section 1(1) includes any payment made in relation to a supply of goods or services, whether in money or otherwise.

The payment made by the member to the loyalty partner for the original supply of goods or services is consideration for the said supply.

Allocation of a loyalty point

Refer to Transaction 3 in the respective diagrams in **3.3**.

The allocation of a loyalty point constitutes a “supply” as envisaged in the definition in section 1(1). A “service” is defined in section 1(1) to include, amongst others, the granting, assignment, cession or surrender of a right. Taking into account the above, the allocation, transfer or cession of a loyalty point from one person to another constitutes the supply of a service.

In terms of section 9(1), the time of supply of goods or services is deemed to be the earlier of the date of issue of an invoice or the date of payment being received for the said supply.

One of the characteristics of a loyalty programme, as discussed in **3**, is that loyalty points must be allocated to the member for no additional consideration. The definition of an “invoice” in section 1(1) refers to a document which notifies the recipient thereof of an obligation to make payment. As the LPO will not receive any payment for the loyalty points allocated, there should generally not be an invoice issued for the loyalty points allocated.

Based on the above, it is unlikely that the allocation of the loyalty points triggers the time of supply rules as set out in section 9(1) and therefore, the allocation should not have any VAT implications.

Input tax

Loyalty partner

The original supply

The goods or services acquired for the purpose of making the original supply will be subject to the general provisions governing input tax.

LPO*Allocation of loyalty points*

The allocation of loyalty points forms part of the enterprise conducted by the LPO of managing the loyalty programme. The goods or services acquired for the purpose of allocating loyalty points will therefore be subject to the general provisions governing input tax.

Member*The original supply*

The VAT incurred on the original supply may be deducted as input tax to the extent that the member is a vendor and the goods or services were acquired for the purpose of making taxable supplies and is subject to the general provisions governing input tax.

Allocation of loyalty points

Taking into account the fact that no VAT is charged on the allocation of a loyalty point, the member will not be entitled to deduct any input tax on the receipt of the said points.

Example 2 – The VAT implications of the original supply and subsequent allocation of loyalty points*Facts:*

Member A makes eligible purchases at a loyalty partner for R1 100 (inclusive of VAT of R135,09) (the original supply). The goods supplied to the member were originally purchased by the loyalty partner from a vendor for R800 (inclusive of VAT of R98,25).

The LPO subsequently allocates 220 (R1 100 / R5) loyalty points to Member A.

Result:

The loyalty partner supplies the goods to the member in the course or furtherance of its enterprise and is therefore liable for output tax of R135.09.

As the goods were originally acquired by the loyalty partner wholly for the purpose of making taxable supplies, the loyalty partner will be entitled to an input tax deduction of R98,25.⁸

The loyalty partner's net VAT liability can be set out as follows:

	R
Output tax	135,09
Input tax	98,25
Net VAT liability	36,84

The VAT incurred by Member A of R135,09 will be subject to the general provisions governing input tax.

⁸ Based on the assumption that the documentary requirements contained in section 16(2) and (3) were met.

The allocation of the 220 loyalty points from the LPO to Member A will not have any VAT implications.

4.3 Payments between the LPO and the loyalty partner

As previously indicated, the loyalty partner may be required to make two different types of payments to the LPO (refer to Transaction 5 in the diagrams in 3.3):

- An annual/monthly/weekly management fee, whether fixed or commission-based; and
- An amount equal to the value of the loyalty points allocated by the LPO to members as a result of eligible purchases made at the loyalty partner (the points fee).

4.3.1 Management fee

Output tax

LPO

The management of the loyalty programme by the LPO is a supply of “services” made in the course or furtherance of the LPO’s enterprise and will therefore be subject to VAT under section 7(1)(a).

The management fee charged represents consideration for the supply of “services” made by the LPO to the loyalty partner. Taking into account section 10(2) and (3), the value of the supply made by the LPO will be equal to the consideration, for example the amount of the management fee.

Input tax

LPO

The goods or services acquired for the purpose of earning the management fee will be subject to the general provisions governing input tax.

Loyalty partner

The VAT incurred on the management fee paid by the loyalty partner to the LPO is subject to the general provisions governing the deduction of input tax.

4.3.2 Points fee

The points fee is an amount paid by the loyalty partner to the LPO based on the value of the loyalty points allocated to the member and is separate from the management fee paid by the loyalty partner.

Output tax

LPO

The points fee is not regarded as consideration for a supply made by the LPO and is therefore not subject to VAT under section 7(1)(a).

Example 3 – The VAT implications of the management fee and the points fee

Facts:

The loyalty partner pays a monthly management fee of R10 000 (inclusive of VAT of R1 228,07) to the LPO.

Based on purchases made at the loyalty partner, the LPO allocates 220 (R1 100 / R5) loyalty points to Member A. The loyalty partner pays the LPO an amount of R22 (220 loyalty points × 10c) (points fee), for the loyalty points allocated.

The loyalty partner makes only taxable supplies.

Result:

The LPO will be liable for output tax of R1 228,07 on the taxable service supplied to the loyalty partner (that is, the management of the loyalty programme).

As the loyalty partner only makes taxable supplies, the loyalty partner will be able to deduct the VAT incurred of R1 228,07 on the acquisition of the management services as input tax subject to the general requirements governing the deduction of input tax.

The points fee is not consideration for a supply of goods or services and will therefore not be subject to VAT under section 7(1)(a).

4.4 Redemption of a loyalty point

After a member has accumulated sufficient loyalty points, the member may redeem such loyalty points for goods or services of a similar value (refer to Transaction 4 in the diagrams in **3.3**). In terms of section 10(2), the value placed on a supply of goods or services is determined in relation to the consideration for the said supply, under the provisions of section 10(3). As a result, it must be determined whether loyalty points offered as payment by the member for the goods or services acquired from the redemption partner forms part of the consideration for the supply made by the said redemption partner.

A “*loyalty credit or reward*” is specifically included in the definition of a “consideration” in section 1 of the CPA. Section 35 of the CPA elaborates by stating that –

“loyalty credits or rewards are 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.”

The term “consideration” is defined in section 1(1) to include, amongst others, payments and certain acts and forbearances in relation to a supply of goods or services, whether for money or otherwise.

At point of redemption, the member offers the loyalty point as payment (or part payment) for the supply made by the redemption partner. The loyalty points therefore form part of the consideration for the supply made by the redemption partner to the member.

4.4.1 The exclusive programme⁹

Output tax

LPO

Based on the fact that loyalty points are consideration for the supply made by the LPO when the loyalty points are being redeemed by the member but the LPO receives no cash or any other benefit for the value of the loyalty points accepted as payment, the LPO will be out-of-pocket to the extent that goods or services supplied are “paid for” by loyalty points. It is therefore proposed that relief be granted to the LPO.

In order to achieve the aforementioned, loyalty points accepted as payment (or part-payment) for the supply of goods or services by the LPO in an exclusive programme should be excluded from the “consideration” for the said supply.

The exclusion of loyalty points from “consideration” as defined in section 1(1) will result in the consideration for the supply made by the LPO consisting of only additional payments¹⁰ made by the member for the said supply. The effect is that the LPO is only liable to account for VAT on the additional payments received.

As the VAT Act does not currently provide for the aforementioned, certain amendments to the said Act may be required.

Input tax

LPO

VAT incurred on goods or services acquired for the purpose of making supplies to the member (which were “paid for” by loyalty points) will be subject to the general provisions governing input tax.

Member

The VAT incurred on the goods or services acquired from the LPO, that is,. the tax fraction of the additional consideration for the supply of goods or services made by the LPO, is subject to the general provisions governing input tax.

Example 4 – The VAT implications when loyalty points are redeemed for goods or services

Facts:

Member A purchases goods for R55 (inclusive of VAT of R6,75) at an LPO. Member A chooses to redeem 200 loyalty points (i.e. R20) as part-payment for the goods supplied. Member A therefore remains liable for an amount of R35 (R55 – R20) which Member A paid for in cash.

⁹ For purposes of an exclusive programme, the loyalty partner, LPO and redemption partner is the same person. As a result, only reference to the LPO will be made throughout this paragraph.

¹⁰ The term “additional payments” in this regard refers to any other payments made by the member in relation to the supply made by the LPO other than by the redemption of loyalty points (e.g. cash payments).

Result:

Current VAT legislation

The value of loyalty points is included in the consideration for the goods supplied to Member A by the LPO. As a result, the LPO will be liable for output tax on the gross value of the supply (i.e. R55).

The VAT incurred by Member A of R6,75 will be subject to the general provisions governing input tax.

Proposed position

LPO

The output tax liability on the goods supplied to Member A will be calculated as follows:

	Value in Rand	Consideration	Output tax @ 14%
200 loyalty points	20	0	0
Additional payments	35	35	4,29
Total	55	35	4,29

Member A

The VAT incurred by the member of R4,29 will be subject to the general provisions governing input tax.

4.4.2 The multiple party programme

In terms of the Redemption Agreement, the redemption partner has the right to receive cash from the LPO to the value of the loyalty points received as payment for supplies of goods or services made by it to a member (that is, the redemption cost). The value of the loyalty points accepted as payment must therefore be included in the consideration for the supply made by the redemption partner to the member.

Example 5 – The VAT implications when loyalty points are redeemed for goods or services

Facts:

Member A purchases goods for R55 (inclusive of VAT of R6,75) at a redemption partner. Member A chooses to redeem 200 loyalty points (i.e. R20) as part payment for the goods supplied. Member A therefore remains liable for an amount of R35 (R55 – R20) which Member A paid for in cash.

Result:

Redemption Partner

The consideration for the goods supplied by the redemption partner includes both the value of the loyalty points as well as the cash offered as payment by Member A. The value of the supply with the subsequent output tax liability is calculated as follows:

	Value in Rand	Consideration	Output tax @ 14%
200 loyalty points	20	20	2,46
Additional payments	35	35	4,29
Total	75	75	9,21

Member A

The VAT incurred by the member of R6,75 will be subject to the general provisions governing input tax.

4.4.3 Donations

In certain instances, under the loyalty programme, the LPO make donations to various entities, for example schools, welfare or any other similar entities, based on the value of purchases made by the member of the loyalty programme.

In light of the fact that the LPO, when making such donation, does not acquire any goods or services in the course or furtherance of its enterprise, the LPO may not deduct any VAT incurred as input tax in this regard.

4.5 Payments between the LPO and the redemption partner

As previously indicated, the following two payments may occur between the redemption partner and the LPO (refer to Transaction 6 in the diagrams in 3.3):

- An annual/monthly/weekly management fee, whether fixed or commission-based, paid by the redemption partner to the LPO (refer to 4.3.1 for the VAT treatment of the management fee); and
- An amount paid by the LPO to the redemption partner equal to the value of the loyalty points offered by the members as payment for supplies made by the redemption partner (the redemption cost).

4.5.1 Redemption cost

The redemption partner will be out-of-pocket to the extent that the member redeems loyalty points for goods or services supplied as the loyalty points have no commercial value to the redemption partner (refer to 4.5). In order for the redemption partner to convert the loyalty points accepted as payment into cash (that is, being compensated for being out-of-pocket), the LPO pays the redemption partner an amount equal to the value of the loyalty points accepted as payment for the supply of goods or services made to the member (redemption cost).

Based on discussions within the industry, the practical implementation of the redemption cost may vary. In certain instances the redemption partner will send a statement, whether daily, weekly or monthly, to the LPO indicating the number and/or value of loyalty points accepted as payment for supplies made by it. The LPO will then make a payment to the redemption partner equal to the value of the said loyalty points.

In other instances, the cash is paid immediately to the redemption partner as soon as a card is swiped and loyalty points are redeemed as payment for a supply made by the redemption partner. In these instances, loyalty points are treated equal to cash.

Irrespective of the manner in which the redemption cost is paid to the redemption partner, it is proposed that the VAT treatment thereof is the same.

*Output tax*Redemption partner

The redemption of a loyalty point is akin to that of a voucher as envisaged in section 10(18). As a result, the redemption cost is not consideration for a supply made by the redemption partner.

Current legislation does not provide for the redemption cost to be treated similar to vouchers. In this regard, an amendment is proposed.

*Input tax*Redemption partner

Taking into account the fact that no VAT is charged on the redemption cost, the redemption partner will not be entitled to deduct any input tax on the payment thereof.

LPO

Goods or services acquired in the course or furtherance of paying the redemption cost are subject to the general provisions governing input tax.

Example 6 – The VAT implications of the management fee and redemption cost*Facts:*

Member A purchases goods for R55 (inclusive of VAT of R6,75) at a redemption partner. Member A chooses to redeem 200 loyalty points (i.e. R20) as part payment for the goods supplied. Member A therefore remains liable for an amount of R35 (R55 – R20) which Member A paid for in cash. After the redemption partner has supplied Member A with the goods, the LPO pays the redemption partner an amount of R20 (200 loyalty points × 10c).

*Result:**Supply of the goods or services*

The consideration for the goods supplied by the redemption partner includes both the value of the loyalty points as well as the cash offered as payment by Member A. The value of the supply with the subsequent output tax liability is calculated as follows:

	Value in Rand	Consideration	Output tax @ 14%
200 loyalty points	20	20	2,46
Additional payments	35	35	4,29
Total	75	75	9,21

Member A will be eligible to deduct the input tax of 6.75 to the extent that the goods were acquired for the purpose of making taxable supplies subject to the general provisions governing input tax.

Redemption cost

The redemption cost of R20 is not consideration for a supply made by the redemption partner and is therefore not subject to VAT under section 7(1)(a).

4.6 Loyalty points sold by the LPO to the member

The sale of loyalty points is not a very common practice within the industry as most loyalty programmes allow part-payment of goods or services should sufficient loyalty points not be available for redemption.

From discussions with the industry, it is understood that the purchase of additional loyalty points by a member is only allowed in limited circumstances and is subject to strict requirements and rules. The value at which the loyalty points are sold by the LPO usually represents the fair value of the said loyalty points.

4.6.1 Sale of a loyalty point

Output tax

LPO

The sale of a loyalty point is a supply of “services” as envisaged in its definition in section 1(1) and will therefore be subject to VAT under section 7(1)(a). The time of supply, governed by section 9(1), will be triggered by the earlier of the date of invoice or the date of payment.

Based on discussions with certain stakeholders, loyalty points can be redeemed for a variety of products. At the time the loyalty points are sold by the LPO, the character or nature of the goods or services for which these loyalty points will be redeemed is not yet known. As a result, a difficulty arises as to whether VAT should be levied on the supply of the loyalty points at point of sale.

Section 10(18) addresses a similar difficulty with regard to the issue of a voucher, stamp or token which provides the holder thereof with the right to receive goods or services to the extent of a monetary value stated thereon. In terms of this section, the supply of the voucher, stamp or token will be disregarded for VAT purposes, except where the consideration received for such voucher, stamp or token exceeds the monetary value stated thereon. According to paragraph 5.6.15(a) of the Explanatory Memorandum on the Value-Added Tax Bill, 1991, “*the token, voucher or stamp is regarded as a medium of exchange similar to money*” and must therefore be included in the consideration of the goods or services for which the token will be exchanged.

As section 10(18) does not currently apply to loyalty points, the selling of the points would be a supply of a right. As a result, the loyalty points supplied to the member by the LPO is subject to VAT under section 7(1)(a) at the standard rate of 14% (subject to the zero-rating provisions contained in section 11) at point of sale. At point of redemption, the loyalty points redeemed by the member will constitute consideration for the goods or services supplied by the redemption partner. Double taxation would therefore occur where loyalty points are sold to and subsequently redeemed by a member.

Based on the above, it is proposed that the VAT treatment of loyalty points be equivalent to the sale of vouchers as envisaged under section 10(18). As a result, loyalty points with a monetary value should be disregarded for VAT purposes. Taking into account the fact that the VAT Act does not currently provide for this, amendments are required in this regard.

*Input tax*LPO

The VAT incurred by the LPO on goods or services acquired for the purpose of selling a loyalty point is subject to the general provisions governing input tax.

Member

Taking into account the proposed position as discussed above (that is, no VAT is charged at the point when loyalty points are sold to a member), the member may not deduct any input tax on the acquisition of the said points.

4.6.2 Redemption of loyalty points sold to a member*Output tax*Redemption partner

Taking into account that it is proposed that the sale of loyalty points be disregarded for VAT purposes based on a principle similar to section 10(18) (refer to **4.6.1**), the value of the loyalty points offered as payment for goods or services supplied by the redemption partner should form part of the consideration for the said goods or services.

*Input tax*Member

The VAT incurred by the member on the goods or services acquired from the redemption partner will be subject to the normal provisions governing input tax.

Example 7 – The VAT implications when loyalty points originally sold by the LPO to members are offered as payment for the future supply of goods or services

Facts:

Member A purchases goods for R55 (inclusive of VAT of R6,75) at a redemption partner. Member A chooses to redeem 400 loyalty points (i.e. R40) as part payment for the goods supplied. Member A therefore remains liable for an amount of R15 (R55 – R40).

Member A is in possession of loyalty points as follows:

- 220 – allocated as a result of eligible purchases made by Member A; and
- 200 – purchased.

*Result:**Current VAT legislation*

The loyalty points sold by the LPO to the member is subject to VAT under section 7(1)(a) at the standard rate of 14% (subject to the zero-rating provisions contained in section 11) at point of sale.

At point of redemption, the value of the loyalty points redeemed by the member must be included in the calculation of the value of the consideration for the goods supplied by the redemption partner.

Proposed position

Assuming the loyalty points are redeemed on a first-in-first-out basis, the following loyalty points are applied toward redemption:

- 220 allocated loyalty points with a value of R22; and
- 180 purchased loyalty points with a value of R18.

The consideration for the goods supplied by the redemption partner is R55. The redemption partner's output tax liability in respect of the said supply is R6,75 ($R55 \times 14 / 114$). The loyalty points are regarded as consideration for the goods supplied by the redemption partner regardless of whether the loyalty points were originally allocated or sold to Member A.

The VAT incurred of R6,75 by Member A will be subject to the general provisions governing input tax.

4.6.3 Redemption cost of loyalty points sold to a member*Output tax*Redemption partner

Based on the proposal that the principles of section 10(18) should apply to the sale of loyalty points, the redemption cost paid to the redemption partner by the LPO must be excluded from the consideration for the supply made by the redemption partner in order to avoid double taxation. Following the principles of vouchers in a similar scenario, the redemption cost is not payment in respect of a specific supply made by the redemption partner. As a result, the redemption cost is not subject to VAT under section 7(1)(a).

*Input tax*LPO

Based on the proposal, the payment made by the LPO to the redemption partner is not subject to VAT under section 7(1)(a). As a result, the LPO is not able to deduct any VAT thereon.

Member

The VAT incurred by the member on the goods or services acquired from the redemption partner will be subject to the general provisions governing input tax.

Example 8 – The VAT implications of the redemption cost on loyalty points originally sold to the member when offered as payment for the acquisition of goods or services*Facts:*

Member A purchases goods for R55 (inclusive of VAT of R6.75) at a redemption partner. Member A chooses to redeem 400 loyalty points (i.e. R40) as part payment for the goods supplied. Member A therefore remains liable for an amount of R15 ($R55 - R40$).

Member A is in possession of loyalty points as follows:

- 220 – allocated as a result of eligible purchases made by Member A; and

- 200 – purchased by the member.

After the redemption partner has supplied Member A with the goods, the LPO compensates the redemption partner for an amount of R20 (200 loyalty points × 10c).

Result:

The consideration for the goods supplied by the redemption partner is R55. The redemption partner's output tax liability in respect of the said supply is R6,75 (R55 × 14 / 114). The loyalty points are regarded as consideration for the goods supplied by the redemption partner regardless of whether the loyalty points were originally allocated or sold to the Member A.

The VAT incurred by Member A of R6,75 is subject to the general provisions governing input tax.

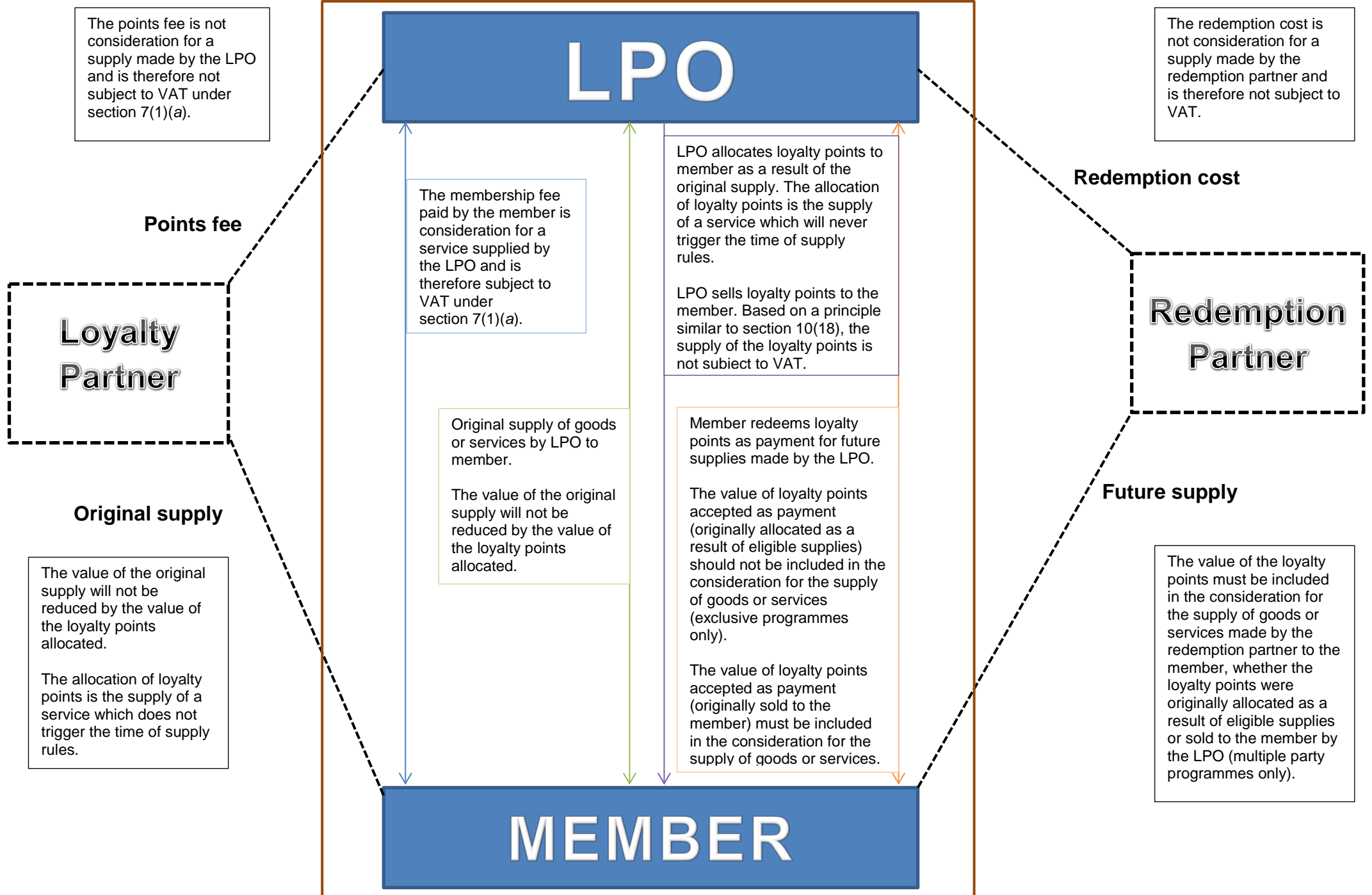
The redemption cost, whether received in respect of loyalty points originally allocated or sold to Member A, is not consideration in respect of a supply made by the redemption partner to the LPO. As a result, the redemption cost is not subject to VAT under section 7(1)(a).

4.7 Summary of proposed position

4.7.1 VAT principles

Loyalty programmes are used as incentive schemes to encourage loyalty by rewarding customers. The purpose of an LPO is to market the loyalty programme, manage the loyalty points allocated to members and to ensure that members obtain the rewards to which they are entitled. Certain loyalty programmes consist of the LPO as well as other partners from whom loyalty points can be earned and/or redeemed by the member.

Based on the information set out in this document, the proposed VAT treatment of the various transactions within a loyalty programme can be summarised as in the following diagram:



4.7.2 Comprehensive example – Exclusive programme

The example set out below follows the proposed treatment as set out above and takes into account the proposed amendments to the VAT Act as discussed throughout this document.

Facts:

EcoPots is a retailer of environmentally friendly pots (eco-pots) specially designed for houseplants. In order to gain additional market share, EcoPots is operating a loyalty programme whereby frequent customers are rewarded for their loyalty. In terms of this programme, points are awarded to customers as follows:

- 10 points for every small eco-pot purchased;
- 20 points for every medium eco-pot purchased; and
- 30 points for every large eco-pot purchased.

Each point allocated to a member is valued at 10c and may be redeemed for further eco-pots. EcoPots does not allow a member to part-pay for eco-pots which have been “paid” for by points but allows members to purchase additional points at its fair value, i.e. 10c each.

M (a registered VAT vendor) is a retailer of various garden and indoor plant products and has therefore decided to become a member of EcoPot’s loyalty programme.

M subsequently earned points to the value of R38 as a result of eligible purchases made at EcoPots of R11 250.

M decides to redeem all of the points to purchase a large eco-pot at Pothouse, valued at R55. As M does not have sufficient points to cover the full price of this eco-pot, M is required to purchase an additional 1 700 points for an amount of R17.

Result:

Original supply of goods or services

Value of supplies	Ecopots		M	
	Output	Input	Output	Input
11 250	1 381,58			(1 381,58)

Allocation of points

The allocation of the points as a result of eco-pots purchased at the relevant partners will have no VAT consequences (refer to **4.2**).

Sale of additional points

Following the principle of section 10(18), the points will have no VAT consequences at the point of sale (refer to **4.6**).

Redemption of the points for the eco-pot

The value of the loyalty points which were originally allocated to M must be excluded from the value of the consideration for the supply of the eco-pot (refer to **4.4.1**). The consideration received by EcoPots in respect of the supply made to M is equal to the

value of the loyalty points being redeemed which were originally sold to M (that is, R17) (refer to 4.6). The output tax liability of EcoPots in this regard is R2,09 (R17 x 14 / 114).

4.7.3 Comprehensive example – Multiple party programme

The example set out below follows the facts set out in the previous paragraph but sets out the proposed position of the transactions within a multiple party programme.

Facts:

EcoPots is a retailer of environmentally friendly pots (eco-pots) specially designed for houseplants. In order to gain additional market share, EcoPots is operating a loyalty programme whereby frequent customers are rewarded for their loyalty. In terms of this programme, points are awarded to customers as follows:

- 10 points for every small eco-pot purchased;
- 20 points for every medium eco-pot purchased; and
- 30 points for every large eco-pot purchased.

Each point allocated to a member is valued at 10c and may be redeemed for further eco-pots. EcoPots does not allow a member to part-pay for eco-pots which have been “paid” for by points but allows members to purchase additional points at its fair value, i.e. 10c each.

In an effort to make the loyalty programme more accessible, EcoPots has decided to broaden the scope thereof by inviting other group entities to become partners to the loyalty programme. These group entities are similar retailers of eco-pots situated in different locations throughout the country and include Pots&Plants, PotHouse and PotsGalore. Members will be able to earn or redeem points at these retailers in the same manner as it would at EcoPots.

EcoPots has entered into agreements with its partners whereby it will keep record of the points allocated and redeemed by each member. For this administration service supplied, EcoPots will charge a monthly administration fee of R11 400 (including VAT of R1 400). Each partner will be liable to compensate EcoPots for the value of the points allocated to members as a result of eligible eco-pot purchases at the said partner (the points fee). EcoPots will in turn be liable to compensate a partner where a member has redeemed its points as payment for eco-pots (the redemption cost). Both the points fee and redemption cost is exclusive of VAT, where applicable.

M (a registered VAT vendor) is a retailer of various garden and indoor plant products and has therefore decided to become a member of EcoPot’s loyalty programme. M is charged an annual membership fee of R100 (excluding VAT of R14).

M subsequently earned points from the various partners as follows:

Partner	Amount paid for eco-pots (R)	Number of points earned	Value of points earned (R)
EcoPot	2 750	1 000	10
Pots&Plants	3 000	1 000	10
PotHouse	825	300	3

PotsGalore	4 675	1 500	15
Total	11 250	3 800	38

M decides to redeem all of the points to purchase a large eco-pot at Pothouse, valued at R55. As M does not have sufficient points to cover the full price of this eco-pot, M is required to purchase an additional 1 700 points for an amount of R17.

Result:

Fees

	EcoPot		Partner ¹¹		M	
	Output	Input	Output	Input	Output	Input
Administration fees	1 400			(1 400)		
Membership fees	14					(14)
The fees are consideration for the services supplied by EcoPots. The supply of the services is taxable under section 7(1)(a) (refer to 4.1).						

Original supply of goods or services

	Value of supplies	Partner		M	
		Output	Input	Output	Input
EcoPot	2 750	337,72			(337,72)
Pots&Plants	3 000	368,42			(368,42)
Pothouse	825	101,32			(101,32)
PotsGalore	4 675	574,12			(574,12)

Allocation of points

The allocation of the points as a result of eco-pots purchased at the relevant partners will have no VAT consequences (refer to 4.2).

Points fee

The points fee is not consideration for a supply and therefore no VAT is levied.

Sale of additional points

Following the principle of section 10(18), the points will have no VAT consequences at the point of sale (refer to 4.6).

¹¹ Based on the assumption that the relevant partner makes wholly taxable supplies and that the documentary requirements contained in sections 16(2) and (3) have been met.

Redemption of the points for the eco-pot

The consideration for the eco-pot supplied by Pothouse is R55. The output tax liability in respect of the said supply is R6,75 ($R55 \times 14 / 114$). The loyalty points are regarded as consideration for the goods supplied by Pothouse regardless of whether the loyalty points were originally allocated or sold to M (refer to **4.4.2** and **4.6**).

Redemption cost

The redemption cost, whether received in respect of loyalty points originally allocated or sold to the member, is not consideration in respect of a supply made by Pothouse to EcoPots (refer to **4.5.1** and **4.6.3**). As a result, the redemption cost is not subject to VAT under section 7(1)(a).

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE