

INTERPRETATION NOTE 118

DATE: 4 November 2021

ACT : VALUE-ADDED TAX ACT 89 OF 1991
SECTION : SECTION 1(1) DEFINITIONS OF “CONSIDERATION”, “INPUT TAX” AND “SUPPLY”,
SECTIONS 7 AND 10
SUBJECT : VALUE-ADDED TAX CONSEQUENCES OF POINTS-BASED LOYALTY PROGRAMMES

Contents

Preamble.....	2
1. Purpose.....	3
2. The law.....	3
3. Characteristics of a loyalty programme.....	3
4. Transactional flow of loyalty programmes.....	5
4.1 Diagram depicting transactional flow of loyalty programmes.....	5
4.2 Different structures of a loyalty programme	7
4.2.1 The exclusive programme	7
4.2.2 The multiple party programme.....	7
4.3 Nature of a loyalty point	7
5. Application of VAT principles	8
5.1 Participation in a loyalty programme (transactions 1, 5.1 and 7.1 of the diagram)	8
5.1.1 Output tax.....	9
5.1.2 Input tax.....	9
5.2 Original supply of goods or services (transaction 2 in the diagram).....	10
5.2.1 Output tax.....	10
5.2.2 Input tax.....	11
5.3 Awarding of loyalty points (transaction 3 in the diagram)	12
5.3.1 Output tax.....	12
5.3.2 Input tax.....	12
5.4 Sale of a loyalty point (transaction 4 in the diagram)	13
5.4.1 Output tax.....	13
5.4.2 Input tax.....	13
5.5 Payment of points fee (transaction 5.2 of the diagram)	14

5.5.1	Output tax.....	14
5.5.2	Input tax.....	14
5.6	Transfer of loyalty points between members	15
5.6.1	Output tax.....	15
5.7	Awarding of loyalty points under an employment incentive scheme	15
5.8	Redemption of a loyalty point (transaction 6 in the diagram).....	16
5.8.1	Output tax.....	16
5.8.2	Input tax.....	17
5.9	Payment of redemption cost (transaction 7.2 in the diagram)	18
5.9.1	Output tax.....	18
5.9.2	Input tax.....	19
5.10	Conversion of loyalty points	19
5.11	Expiration of loyalty points	20
6.	Conclusion	20
	Annexure – The law	21

Preamble

In this Note unless the context indicates otherwise –

- “**customer**” means any person who buys goods or services from a vendor;
- “**CPA**” means the Consumer Protection Act 68 of 2001;
- “**loyalty partner**” means a person that participates in the loyalty programme and sells eligible goods or services to a member on which loyalty points are earned by the said member;
- “**loyalty points**” means miles, loyalty points or any other similar items (whether tangible or intangible) allocated to a member, which may be used by the member as payment for goods or services or entitle the member to any other benefit as a reward;
- “**loyalty programme**” means any programme or scheme, with the characteristics set out in 3, under which the reward to the member is quantified using loyalty points (also referred to as a points-based loyalty programme);
- “**LPO**” means the loyalty programme operator responsible for the day-to-day management and administration of the loyalty programme;
- “**member**” means a customer who is also a participant in a loyalty programme;
- “**redemption partner**” means a person responsible for making supplies of goods or services to the member for which payment is accepted in the form of loyalty points (either in whole or in part);
- “**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 unless specified otherwise;
- “**stakeholders**” means the LPO, loyalty partner and the redemption partner;

- “**VAT**” means value-added tax;
- “**VAT Act**” means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This Note clarifies the VAT implications resulting from the participation in loyalty programmes based on the current provisions of the VAT Act. This Note does not attempt to list and analyse all the loyalty programmes available. Loyalty programmes differ from each other, evolve and change because of continuous changes in market conditions, competition etc. For this reason, the general VAT principles applicable to loyalty programmes as contained in this Note must be analysed and subsequently applied to each transaction in a loyalty programme in accordance with that specific loyalty programme’s characteristics or nature.

Notwithstanding that this Note may in certain instances highlight the VAT implications of other benefits generally associated with loyalty programmes, the main focus of this Note is to address the VAT implications of points-based loyalty programmes. More specifically, this Note concentrates on loyalty programmes that regard loyalty points as a form of payment or part-payment for goods or services, in line with the nature of loyalty points as set out in 4.3. Should any of the agreements referred to in 4.1 contain provisions that specifically contradict this, for instance where the relevant agreements evidence loyalty points to be regarded as a discount on future purchases, this Note does not apply to the specific circumstances.

All examples contained in this Note are based on the assumption that the relevant parties of a loyalty programme are all vendors.

The policies and further applications associated with vouchers, tokens or stamps are not discussed in detail in this Note.

2. The law

The relevant sections of the VAT Act are quoted in the **Annexure**.

3. Characteristics of a loyalty programme

The most prevalent reward schemes used by retailers are those loyalty programmes that use loyalty points as a means of rewarding their customers, also referred to in practice as points-based loyalty programmes. In short, a customer will earn loyalty points on certain purchases or behaviours that will entitle that customer to a future reward, equal to the value of the loyalty points being redeemed.

Loyalty programmes are used by businesses as incentives to encourage sales by offering rewards with the intention of attracting new customers as well as retaining their current customer base. Businesses also use the information gathered throughout this process to, amongst others, identify trends in customer spending, maximise efficiency in their stock management systems and ensure more targeted marketing campaigns.

Loyalty programmes are managed either externally or internally, depending on the availability of resources or structure most suitable to the specific entity. As establishing a new loyalty programme may be cost intensive, it is common for entities to become partners in an already existing loyalty programme. One entity in the loyalty programme, being the LPO, will act as administrator of the loyalty programme, taking on the responsibility and liability of, amongst others, ensuring the correct distribution of benefits to members and advertising or promoting the loyalty programme.

The CPA regulates loyalty programmes from a legal and commercial perspective. A loyalty programme is then also defined in section 1 of the CPA 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”.

For the purposes of this Note, a loyalty programme has **all** of the following characteristics:

- Membership to a loyalty programme is open to any customer of an entity or group of entities, or to the public as a whole.
- Members are entitled to be allocated a reward in the form of loyalty points as a result of their membership to the loyalty programme. The reward is quantified based on, amongst others, the value of goods or services acquired from certain entities, the promotion of a specific behaviour by the member (for instance, the use of a specific type of card¹) or purely because of being a member of the loyalty programme.
- The member is not liable for any additional payment or consideration before becoming entitled to the loyalty points (excluding the membership fee where applicable).
- Members may in some instances pay less for goods or services than other customers. However, at no point should members pay more for goods or services than other customers, or pay an additional amount that could be construed as being consideration for the allocation of loyalty points.
- Loyalty points allocated have a value attached to it, whether specific or notional.
- The loyalty points can be redeemed by the member for goods or services with a value similar or equal to the fair value of the loyalty points used as payment for the said goods or services.

¹ “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. Transactional flow of loyalty programmes

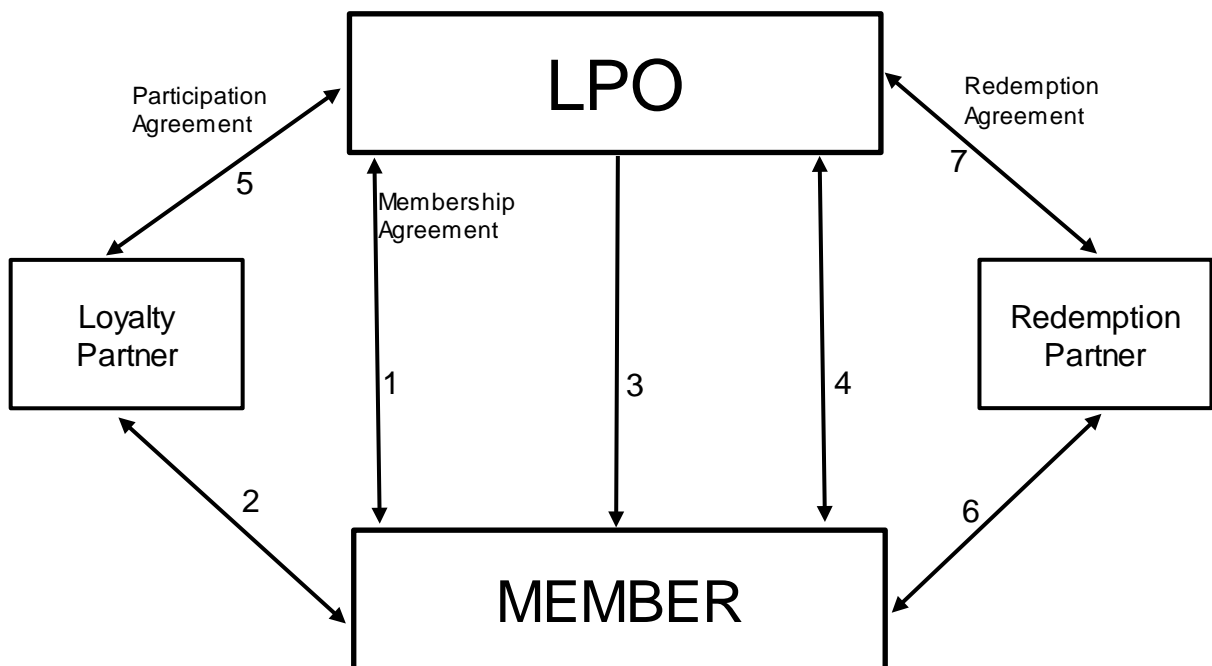
A customer becomes a member of a loyalty programme by entering into a membership agreement with the LPO. Being the administrator of the loyalty programme, the LPO is responsible for the recordkeeping of the various transactions in a loyalty programme, including the loyalty points earned and subsequently redeemed by each member.

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

The member will be entitled to loyalty points based on, amongst others, eligible purchases made from a supplier, being a loyalty partner. A partnership agreement governs the relationship between the LPO and the loyalty partner.

The member will be entitled to redeem the loyalty points earned by offering the loyalty points as payment (or part-payment) for future purchases from the same or another supplier, being a participating stakeholder in the loyalty programme (the redemption partner). A redemption agreement governs the relationship between the LPO and the redemption partner.

4.1 Diagram depicting transactional flow of loyalty programmes



Transaction 1

A customer enters into a membership agreement with the LPO, which entitles the customer to become a member of and participate in the loyalty programme. In certain instances, the member may be required to fulfil certain requirements to qualify for the said programme, such as paying a membership fee or spending a minimum amount of money during a specific time period (see 5.1).

Transaction 2

The member makes eligible purchases from or swipes a card at the loyalty partner (being the original supply) entitling the member to loyalty points on the acquisition of the relevant goods and/or services (see **5.2**).

Transaction 3

The LPO is responsible for allocating loyalty points to the member based on, amongst others, the member's purchases at the loyalty partner (see **5.3**).

Transaction 4

Certain loyalty programmes allow members to purchase additional loyalty points should the value of the loyalty points held by the member be insufficient to be redeemed for certain goods or services (see **5.4**).

Transaction 5

Transactions that occur between the loyalty partner and the LPO are set out in the participation agreement and may include the following:

- *Transaction 5.1*

The loyalty partner pays the LPO a management or administration fee, whether weekly, monthly or annually, for the management of the loyalty programme (see **5.1**).

- *Transaction 5.2*

The loyalty partner pays the LPO a points fee as a result of the members' purchases at the loyalty partner, being the original supply in Transaction 2 (points fee). The points fee can either be equal to the value of the loyalty points allocated to the member resulting from the original supply, or be calculated in some other manner (such as a percentage of the original sale) (see **5.5**).

Transaction 6

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 (see **5.8**).

Transaction 7

Transactions that occur between the redemption partner and the LPO are set out in the redemption agreement and may include the following:

- *Transaction 7.1*

The redemption partner pays the LPO a management or administration fee, whether weekly, monthly or annually, for the management of the loyalty programme (see **5.1**).

- *Transaction 7.2*

The LPO pays the redemption partner the redemption cost. The redemption cost is generally equal to the value of the loyalty points accepted as payment or part-payment for the goods or services supplied. It may however occur that the redemption cost is less than the value of the said loyalty points (see **5.9**).

4.2 Different structures of a loyalty programme

Having regard to the above transactional flow, two main structures of loyalty programmes were identified.

4.2.1 The exclusive programme

An exclusive programme is a loyalty programme that is usually administered in-house with the supplier acting as the only stakeholder to the loyalty programme, meaning the supplier acts in the role of loyalty partner, redemption partner and the LPO. It is therefore the responsibility of the supplier to keep record of the loyalty points earned and subsequently redeemed by each member.

4.2.2 The multiple party programme

A multiple party programme is more complex because more entities are involved in the programme. The stakeholders identified in the aforementioned detailed transactional flow (see 4.1) are typical of a multiple party programme. Either a separate entity or a stakeholder to the programme can manage the loyalty programme. It is also possible that each of the participants can fulfil more than one role, for instance, the LPO can also be the loyalty partner or redemption partner, or the loyalty partner and redemption partner can be the same person.

The loyalty programmes currently operating in the South African market contain different variations of these two structures. The business reason for having a loyalty programme, whether an exclusive or multiple party programme, remains the same, such as for market research and customer rewards purposes. The VAT consequences of a transaction should therefore remain consistent regardless of the amount of stakeholders involved in a specific programme.

For the purpose of simplification, the VAT principles and subsequent application of these principles as discussed in 5 below are explained in the context of a multiple party programme but equally applies to an exclusive programme (where applicable). It is the responsibility of each stakeholder to identify its role and transactions relevant to it within the loyalty programme in order to apply the correct VAT treatment to the relevant transactions.

4.3 Nature of a loyalty point

In essence, a loyalty point is the evidence of a right awarded to a member to tender the loyalty points as a method of payment (or part-payment) for goods or services to be acquired by the member on a future date.

From a VAT perspective, loyalty points compare with the concept of a “token, voucher or stamp” as used in section 10(18), notwithstanding that such concepts are not specifically defined for VAT purposes. In this regard, a “voucher” is defined in the Merriam Webster Dictionary as, amongst others –

“a documentary record of a business transaction”,

or –

“a form or check indicating a credit against future purchases or expenditures”.

Similarly, the Collins Dictionary defines a “voucher” to be –²

“a ticket or piece of paper that can be used instead of money to pay for something”.

Having regard to the context of section 10(18), the concept of a “voucher, token or stamp” in section 10(18) can never be regarded as a discount. Following this logic, as a loyalty point by its nature represents a right to the member to be accepted as payment on a future purchase, similar to that of a voucher, a loyalty point does not represent a discount on a future purchase. Certain ordinary definitions, such as the Oxford Dictionaries Online, refer to a voucher as a discount. These explanations, however, rather refer to a voucher as contemplated in section 10(20), which do not fall within the scope of this Note as set out in 1 above.

The aforementioned is aligned with the legal nature and commercial reality of a loyalty point, as evidenced by the CPA.

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 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”.

The CPA in section 35 also regards loyalty credits or awards as –

“a legal medium of exchange when offered or tendered as consideration for any goods or services offered”.

(Emphasis added.)

5. Application of VAT principles

All transactions akin to a loyalty programme are discussed below with reference to the transactions set out in the diagram contained in 4.1.

5.1 Participation in a loyalty programme (transactions 1, 5.1 and 7.1 of the diagram)

Members may either automatically qualify and participate in a loyalty programme merely by virtue of being a customer of a specific supplier or be required to apply for the right to participate in a loyalty programme. The relationship between the member and other stakeholders to the loyalty programme is governed by a membership agreement. In certain instances, the member is required to fulfil specific requirements as stipulated in the relevant membership agreement before the member qualifies for

² This definition specifically requires a voucher to be on printed matter. It is however acknowledged that due to technological developments, information on vouchers is more often than not displayed electronically rather than on the face value of a printed voucher. As a result, loyalty points electronically reflected would still fall within the concept of a “token, voucher or stamp”.

participation in the loyalty programme. An example of such a requirement is the payment of an annual, monthly or weekly membership fee.

Other entities, such as different suppliers within a group or even third party suppliers, may wish to participate in a loyalty programme as stakeholders instead of creating their own loyalty programme or as an addition to current advertising or promotional products. Such a stakeholder would be required to comply with the loyalty programme rules and grant the member benefits in accordance with the said rules. The administrator of the loyalty programme, being the LPO, may charge the stakeholder a fee for participation in the loyalty programme and/or a management or administration fee as compensation of the administration function performed by the LPO.

5.1.1 Output tax

LPO

The following falls within the ambit of the definition of “services” in section 1(1):

- The granting of a right to participate in a loyalty programme.
- The performance of a management or administration function.

Any fee charged for the supply of either of the aforementioned services in a loyalty programme is consideration for the supply of a service, subject to VAT at the standard rate under section 7(1)(a).³

The LPO is therefore required to declare and pay over to SARS the VAT levied on the services supplied to the member and/or stakeholder in the loyalty programme.

5.1.2 Input tax

Relevant party to the loyalty programme

Should the member or other stakeholder be a registered vendor, the vendor may deduct the VAT incurred on the fee levied by the LPO as input tax to the extent that –

- the participation in the loyalty programme is for the purpose of making taxable supplies; and
- the requirements of section 16(2) and (3) have been met.

Example 1 – Membership in a loyalty programme

Facts:

A is a member of a loyalty programme hosted by Retailer X (being the LPO). In order to participate in this loyalty programme, A has agreed by way of contractual arrangement with Retailer X that A will pay Retailer X R115 per month.

A will get no other benefit from Retailer X other than the right to participate in the loyalty programme.

What are the VAT consequences for Retailer X?

³ Unless the zero-rating provisions under section 11 applies.

Result:

Retailer X is liable to declare and pay output tax on the supply made to A under section 7(1)(a).

$$R115 \times 15 / 115 = R15$$

Should A be a registered vendor, and the membership to Retailer X's loyalty programme is in the course of A's enterprise activities, A is entitled to deduct the VAT incurred of R15 as input tax.

5.2 Original supply of goods or services (transaction 2 in the diagram)

5.2.1 Output tax

Loyalty partner

The member must acquire eligible goods or services from the loyalty partner before loyalty points can be allocated to the member. The supply of these goods or services by the loyalty partner is subject to VAT in accordance with section 7(1)(a), having regard to the zero-rating or exemptions contained in sections 11 and 12 respectively.

Value of the original supply

The general provisions pertaining to the value of a supply as set out in section 10 apply. Accordingly, the value of the original supply of goods or services is equal to the consideration received for such supply,⁴ which includes any payment made in relation to a supply of goods or services, whether in money or otherwise.⁵

The payment of the points fee (the VAT treatment as discussed in **5.5**) is a subsequent event, resulting from a different contract, to the original supply. The contract entered into by the loyalty partner with the member is to make a supply of goods or services. In this regard the contract between the member and the loyalty partner makes no mention of a discount and the member is required to pay the full asking price of the goods or services supplied. The liability of the loyalty partner to the LPO for the points fee is created under a contract entered into with the LPO. Having regard to this, there is not a sufficient nexus between the points fee and the original supply **from a VAT perspective** for it to be argued that the points fee must result in a discount on the value of the original supply made by the loyalty partner.

In light of the above, the payment made by the member to the loyalty partner for the original supply of goods or services is consideration for the original supply. The payment of a points fee by the loyalty partner to the LPO (see transaction 5.2 in the diagram and a full discussion on the VAT consequences of this fee in **5.5**) does not reduce the consideration received by the loyalty partner for the original supply made to the member and therefore does not reduce the value of the original supply for VAT purposes.

⁴ See sections 10(2) and (3), unless specifically otherwise provided for in the VAT Act.

⁵ See the definition of "consideration" in section 1(1).

5.2.2 Input tax

Loyalty partner

The VAT on goods or services acquired for the purpose of making the original supply may be deducted as input tax to the extent that –

- the original supply of goods or services was a “taxable supply” as defined in section 1(1); and
- the requirements of section 16(2) and (3) have been met.

Member

The VAT incurred on the acquisition of goods or services in respect of the original supply may be deducted as input tax if the member is a vendor to the extent that –

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

Example 2 – The original supply of goods or services

Facts:

A purchases goods from Retailer Y to the value of R1 150 (incl. VAT). This purchase entitles A to 50 loyalty points by virtue of it being a member of the loyalty programme administered by Retailer X, being the LPO.

Each loyalty point is worth 20c to Mr A.

What are the output tax consequences for Retailer Y?

Result:

Retailer Y is required to account for and declare the VAT levied on the supply made to A. The VAT amount is $R1\ 150 \times 15 / 115 = R150$.

Example 3 – The original supply of goods or services where a points fee is paid by the loyalty partner

Facts:

Assume the same facts as set out in Example 2 above.

In accordance with the agreement entered into between Retailer X and Retailer Y, Retailer Y is required to pay Retailer X a points fee equal to $50 \times 20c = R10$.

What is the output tax consequences for Retailer Y?

Result:

Retailer Y is required to account for and declare the VAT levied on the supply made to A. The fact that Retailer Y pays to Retailer X a points fee does not have any effect on the value of the supply made by Retailer Y to A.

The VAT amount is therefore the same as in Example 2, namely, $R1\ 150 \times 15 / 115 = R150$.

The VAT consequences of the points fee received by Retailer X is discussed in **5.5**.

5.3 Awarding of loyalty points (transaction 3 in the diagram)

5.3.1 Output tax

LPO

A member becomes entitled to be awarded loyalty points subsequent to an eligible purchase, specific behaviour or other event as stipulated in the membership agreement. These loyalty points represent a right to future goods or services (see also **4.3**).

The awarding of the future rights to the member, being represented by loyalty points, by the LPO under the membership agreement constitutes performance under a contract, resulting in the awarding of the loyalty points being a “supply” as defined in section 1(1).

Value of the supply

One of the characteristics of a loyalty programme is that the loyalty points must be awarded to the member for no additional consideration. As a result, there is no value attached to the supply on which VAT can be levied.

5.3.2 Input tax

LPO

The awarding of loyalty points is an activity performed by the LPO in the course or furtherance of managing or administering the loyalty programme, and therefore forms part of the normal business or enterprise activity of the LPO in this regard. The loyalty points are awarded for no consideration purely because of the reason and nature of their existence, such as for advertising, promotional or information-gathering reasons (see **3**).

In light of the above, the VAT incurred on expenses relating to the awarding of loyalty points (the expenses of which form part of the overhead expenses of the LPO) may be deducted as input tax to the extent that –

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

Member

The member did not incur VAT upon receipt of the loyalty points and is therefore not entitled to an input tax deduction.

Example 4 – Allocation of loyalty points

Facts:

Retailer X, being the LPO, is required to allocate 50 points to A because of eligible purchases made by A at Retailer Y.

What are the VAT consequences on the allocation of loyalty points by Retailer X to A?

Result:

The value of the loyalty points allocated to A is nil. As a result, the allocation of loyalty points has no output tax implications to Retailer X.

Retailer X may, however, deduct any VAT incurred as input tax in allocating the loyalty points to A to the extent that such allocation of loyalty points form part of Retailer X's enterprise activities, such as managing the loyalty programme for which a management fee is charged.

5.4 Sale of a loyalty point (transaction 4 in the diagram)

5.4.1 Output tax

LPO

As previously indicated (see **4.3**), a loyalty point is a “voucher, token or stamp” as envisaged in section 10(18) and (19). The special rules contained in these subsections should therefore be applied where a loyalty point is sold for a consideration. From a VAT perspective, this aligns 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. The CPA clearly allocates the value attached to such prepaid voucher, certificate or credit to the bearer of that voucher, certificate or credit.

As a loyalty point generally does not represent a specific good or service to be supplied (meaning the character or nature of the goods or services for which the loyalty points will be redeemed is unknown at point of sale), it is more common for the sale of a loyalty point to fall within the ambit of section 10(18). According to section 10(18), the supply of the loyalty point must be disregarded for VAT purposes, except to the extent where the consideration received for the loyalty point exceeds the monetary value of the specific loyalty point. The value of the loyalty point forms part of the consideration of the goods or services at time of redemption (see **5.8** for a more detailed discussion on the VAT consequences of transaction 7 as set out in the diagram).

5.4.2 Input tax

LPO

In light of the fact that the sale of loyalty points forms part of the business activity conducted by the LPO (being the management or administration of the loyalty programme), the VAT incurred on expenses relating to the LPO's enterprise (the expenses of which form part of the overhead expenses of the LPO) may be deducted as input tax to the extent that –

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

Member

The member did not incur VAT upon purchasing the loyalty points and is therefore not entitled to an input tax deduction.

Example 5 – Sale of loyalty points*Facts:*

A purchases loyalty points from Retailer X, being the LPO, as a gift for a friend.

What are the VAT consequences of the sale made by Retailer X?

Result:

The sale of the loyalty points is not subject to VAT in accordance with section 10(18).

5.5 Payment of points fee (transaction 5.2 of the diagram)**5.5.1 Output tax***LPO*

The LPO makes no further supplies to the loyalty partner other than those supplies relating to the granting of the right to participate in the loyalty programme or managing or administering the loyalty programme for all stakeholders (see 4 for a detailed discussion on the VAT treatment of these supplies).

As administrator of the loyalty programme, the LPO manages the cash flow of the said programme. Therefore, the points fee is merely money paid by the loyalty partner to enable the member to in future be able to claim the benefit to which the said member is entitled. In essence, the points fee is a manner of monetising loyalty points, being a medium of exchange (see 4.3).

The transfer of “money” as defined in section 1(1) forms part of the management or administration of the loyalty programme but does not in itself have any VAT consequences.

5.5.2 Input tax*LPO*

In light of the fact that the cash or liquidity management forms part of the business activity conducted by the LPO (being the management or administration of the loyalty programme), the VAT incurred on expenses relating to the said cash management (the expenses of which form part of the overhead expenses of the LPO) may be deducted as input tax to the extent that –

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

Loyalty partner

The loyalty partner did not incur VAT upon payment of the points fee and is therefore not entitled to an input tax deduction.

Example 6 – The points fee*Facts:*

Following the facts of Example 3, Retailer Y pays Retailer X (being the LPO) a points fee of R10 for the loyalty points allocated by Retailer X to A for the eligible purchases made by A at Retailer Y.

Result:

The points fee is merely a transfer of money from Retailer Y to Retailer X and therefore falls outside the scope of the VAT net.

5.6 Transfer of loyalty points between members

Certain loyalty programmes allow members to transfer loyalty points between each other, as long as the transfer occurs between members of the same loyalty programme. This supply occurs between the respective members and therefore does not have any impact on the VAT liability of the LPO, loyalty partner or redemption partner respectively.

The LPO is required to re-allocate and facilitate the transfer of the loyalty points from one member's account to another. The LPO will have no further liability with regard to the declaration and payment of any VAT that occurs on the sale of the loyalty points.

The sale of a loyalty point by a member, being a vendor, has the same VAT consequences of a loyalty point sold by an LPO (see 5.4).

5.6.1 Output tax*Selling member*

On assumption that the member is a vendor, the supply of the loyalty points must, under section 10(18), be disregarded for VAT purposes, except to the extent where the consideration received for the loyalty points exceeds the monetary value of the specific loyalty points. The value of the loyalty points forms part of the consideration of the goods or services at time of redemption (see 5.8 for a more detailed discussion).

Acquiring member

The acquiring member, being a vendor, did not incur VAT upon purchasing the loyalty points, and is therefore not entitled to an input tax deduction.

5.7 Awarding of loyalty points under an employment incentive scheme

Employers may reward or incentivise their employees by offering a certain amount of loyalty points in a loyalty programme, generally as a once-off or yearly payment for performance or for the achievement of specific milestones. Employers may either award the loyalty points to the employee free of charge (which is the norm) or for a consideration less than the actual value of the loyalty point.

The VAT implications for each of the above scenarios are as follows:

- Loyalty points are awarded for no consideration, meaning free of charge to the employee (see 5.3).
- Loyalty points are sold to the employee (see 5.4).

Therefore, the supply of the loyalty point to the employee, whether free of charge or for a consideration, is not subject to VAT.

The awarding of the loyalty points by the employer to the employees, however, constitutes a fringe benefit under the Seventh Schedule to the Income Tax Act 58 of 1962. As a result, the employer must levy output tax under section 18(3) by applying the tax fraction to the value of the loyalty points awarded less any consideration received for those points.

The loyalty points awarded under an employment incentive scheme is treated similar to any other loyalty point at time of redemption by the employee (see **5.8**).

5.8 Redemption of a loyalty point (transaction 6 in the diagram)

A member may opt to redeem the loyalty points accrued in many ways, the most common being as payment for the purchase of certain goods or services as a subsequent event. Some loyalty programmes, however, also allow their members to donate the allocated loyalty points to certain pre-approved charity organisations in their own name.

5.8.1 Output tax

Redemption partner

The redemption partner supplies goods or services to the member for which payment is made either in full or in part by the member redeeming his or her loyalty points. The VAT consequences of the said supply follow the nature of the supply made by the redemption partner and are not impacted by the fact that loyalty points are used as payment.

For example, where the member chooses to redeem loyalty points by paying for life insurance at a financial institution, the supply made by the redemption partner is exempt. However, where the member purchases milk at his or her favourite grocery store and pays for the milk by redeeming loyalty points, the supply by the grocery store is taxable at the rate of 0%.

In the event that the member makes a “donation” as defined in section 1(1), the redemption partner (in this instance being the association not for gain receiving the donation) does not make any supply and the transaction has no VAT consequences.

Value of the supply

The value of the goods or services supplied by the redemption partner to the member must generally be determined with reference to the consideration received by the redemption partner for the said supply made [in accordance with section 10(2)], unless a special valuation rule applies. “Consideration” is defined in section 1(1) to include, amongst others, payment(s) made or to be made **whether in money or otherwise** in relation to a supply of goods or services.

Section 10(3) determines the amount of consideration to be, to the extent that the payment received by the redemption partner is –

- money, the amount of the money; and
- anything other than money, the open market value of the said payment.

Having regard to the above as well as section 35 of the CPA (see also 4.3), the consideration received by the redemption partner for the supply of the goods or services to the member includes both the amount of the money received as well as the open market value of the loyalty points. The open market value of loyalty points is generally the value attributed to such loyalty points by the LPO or that portion of the agreed-upon selling price of the goods or services that is paid for by way of redeeming loyalty points.

Loyalty points that were sold to a member and not allocated as a result of an original supply must equally be included in the determination of the consideration of the supply of goods or services made by the redemption partner.

Discount

It is recognised that LPOs may structure their loyalty programmes in such a way that the benefit or right granted to a member is specifically identified as a discount on the supply of future goods or services. Should this be the case, the LPO and stakeholders in the loyalty programme must take cognisance of, amongst others, the fact that the discount granted (equal to the value of the loyalty points redeemed) must be apportioned between the taxable nature of the goods or services supplied by the redemption partner. For example, if the member redeems the loyalty points for milk (being a zero-rated supply) and a bar of chocolate (being a standard-rated supply), the discount applied by the redemption partner must be applied proportionally to the two goods supplied. LPOs must further consider other legislation that may impact the legality of a discount being applied by a redemption partner on the supply made to the member.

It is highlighted that this Note will not apply in the scenario where loyalty points are identified as discounts on future purchases in the relevant agreements (see also 1).

5.8.2 Input tax

Redemption partner

The VAT incurred by the redemption partner to make the supply of the goods or services to the member is subject to the general provisions governing input tax. As a result, the VAT incurred may be deducted as input tax to the extent that –

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

Member

On assumption that the member is a vendor, the VAT incurred by the member, being the VAT amount displayed on the face of the tax invoice, may be deducted as input tax to the extent that –

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

Example 7 – Redemption of loyalty points*Facts:*

A has accumulated 5 000 loyalty points over the past few months and decides to use these loyalty points when making the next purchase at Retailer Z, a redemption partner in the loyalty programme administered by Retailer X (being the LPO).

Each loyalty point is worth 20c to A.

A acquires taxable services from Retailer Z to the value of R2 500 and redeems all 5 000 loyalty points, with a value of R1 000. A therefore has to make an additional payment of R1 500.

What are the VAT consequences of the sale made by Retailer Z?

Result:

The supply of the services made by Retailer Z is subject to VAT at the appropriate rate. The consideration for the supply includes both the value of the loyalty points (being R1 000) and the consideration in money (R1 500).

5.9 Payment of redemption cost (transaction 7.2 in the diagram)**5.9.1 Output tax***Redemption partner*

A loyalty point by its nature is not a commodity that has any marketable value outside the scope of a specific loyalty programme. At point of redemption, the redemption partner has not yet realised the monetary value of the loyalty points accepted as payment for the supply of goods or services to the member until such time that the LPO (in its capacity of administering the loyalty programme and managing the distribution of cash within the said programme) converts the loyalty points into cash. The redemption partner does not supply the loyalty points to the LPO. The loyalty points are merely converted into cash in accordance with the rights and liabilities assigned to the various parties in the redemption agreement.

There is no other supply made by the redemption partner to the LPO for which the redemption cost is consideration. As a result, the payment made by the LPO is merely a transfer of money to the redemption partner. The transfer of “money” as defined in section 1(1) forms part of the management or administration of the loyalty programme but does not in itself have any VAT consequences.

In some instances there is an arrangement between the LPO and the redemption partner that the money transferred by the LPO to the redemption partner may only be a certain portion of the value of the loyalty points accepted as payment for the supply made to the member. For example, 80% of the value of the loyalty points accepted as payment. As the payment of the redemption cost is regulated under a different agreement than the supply made by the redemption partner to the member, the value of the redemption cost does not influence the value of the supply made to the member. As a result, the redemption partner is not entitled to a deduction on the shortfall between the value of the loyalty points accepted as payment and the amount of the redemption cost received from the LPO, nor does the reduced redemption cost influence the value of the supply made by the redemption partner to the member. There is thus no discount on the supply made by the redemption partner to the member.

The shortfall of the redemption partner between the value of the loyalty points accepted as payment and the monetary value received from the LPO can also not be regarded as being an unrecovered or irrecoverable debt as envisaged in section 22 as there is no debt created at point of sale to the member. What should, however, be considered is whether the Redemption Agreement contains specific provisions that govern this shortfall. For instance, is the shortfall a netted amount between the redemption cost and a fee payable by the redemption partner? If so, each transaction must be separately identified and the VAT Act applied accordingly to each transaction.

Applicability of section 10(20)

Section 10(20) acknowledges the use of a voucher that represents a discount granted by one vendor, generally the manufacturer of a specific product, to the ultimate purchaser of the said product (being the customer) at or through another vendor (being the retailer at which the customer purchased the specific product). Although a loyalty point constitutes a “token, voucher or stamp” as used in context of these special valuation rules, the purpose of using loyalty points is not to provide a discount on the supply of goods or services in the context of section 10(20) (see 4.3). As a result, section 10(20) does not apply in the context of loyalty programmes falling within the scope of this Note.

5.9.2 Input tax

LPO

The LPO did not incur any VAT on the payment of the redemption cost and is therefore not entitled to a deduction.

Example 8 – The redemption cost

Facts:

Following the facts of Example 7, Retailer X, being the LPO, pays Retailer Z a redemption cost of R1 000 for the loyalty points redeemed by A with Retailer Z.

Result:

The redemption cost is merely a transfer of money from Retailer X to Retailer Z and therefore falls outside the scope of the VAT net.

5.10 Conversion of loyalty points

Loyalty programmes may allow members in certain instances to exchange loyalty points held in one loyalty programme (LP1) to the loyalty point equivalent in another loyalty programme (LP2).

By converting the loyalty points held in LP1, the member triggers the redemption of these points, for instance, the loyalty points held in LP1 is redeemed for loyalty points held in LP2. As a result, the LPO of LP2 is the redemption partner in the scenario of LP1 supplying loyalty points to the member for a consideration. The VAT principles of the transactions when loyalty points are converted are as follows:

- The redemption of loyalty points by a member in the context of LP1 (see 5.8).
- The sale of loyalty points by the LPO of LP2 (see 5.4).

5.11 Expiration of loyalty points

As previously indicated, a loyalty point merely represents a right to the member. When that right is not exercised within its lifetime, as is set by way of contract or common law, the right ceases to exist.

Generally, upon expiration of loyalty points, the cash equivalent of such points become, or is reflected as, the LPO's income. There is however no supply made by the LPO and, as a result, there is no taxable event from a VAT perspective.

6. Conclusion

This Note sets out the VAT treatment of the most common transactions in loyalty programmes currently in operation in South Africa. Whilst there may be other types of loyalty programmes, the focus of this Note is to provide legislative certainty to the stakeholders participating in a loyalty programme on the VAT consequences of points-based loyalty programmes, specifically where the loyalty points are regarded as payment or part-payment for goods or services. It is the responsibility of each participant in a loyalty programme to establish the nature of its involvement (or role) in a specific loyalty programme in order to determine the VAT treatment of each transaction.

Should a loyalty programme fall outside the scope of this Note, it is recommended that an application be submitted for a VAT Ruling, under section 41B read with Chapter 7 of the Tax Administration Act 28 of 2011, to obtain certainty on the VAT implications of participating in the specific loyalty programme.

Annexure – The law

Section 1(1) – Definitions

1.000Definitions.—(1) In this Act, unless the context otherwise indicates—

“**enterprise**” means—

- (a) 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;

...

“**input tax**”, in relation to a vendor, means—

- (a) tax charged under section 7 and payable in terms of that section by—
- (i) a supplier on the supply of goods or services made by that supplier to the vendor; or
 - (ii) the vendor on the importation of goods by him; or
 - (iii) the vendor under the provisions of section 7(3);

...

where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose;

“**invoice**” means a document notifying an obligation to make payment.

“**service**” means 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 (c) of the definition of “goods”;

“**supply**” 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, and any derivative of “supply” shall be construed accordingly;

Section 7 – Imposition of tax

7. Imposition of value-added tax.—(1) 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;

calculated at the rate of 15 per cent on the value of the supply concerned or the importation, as the case may be.

Section 10 – Value of supply of goods or services

10. Value of supply of goods or services.—(1) For the purposes of this Act the following provisions of this section shall apply for determining the value of any supply of goods or services.

(2) The value to be placed on any supply of goods or services shall, save as is otherwise provided in this section, be the amount of the consideration for such supply, as determined in accordance with the provisions of subsection (3), less so much of such amount as represents tax: Provided that—

...

(3) For the purposes of this Act the amount of any consideration referred to in this section shall be—

- (a) to the extent that such consideration is a consideration in money, the amount of the money; and
- (b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.

...

(18) Where a right to receive goods or services to the extent of a monetary value stated on any token, voucher or stamp (other than a postage stamp as defined in section 1 of the Postal Services Act, 1998, and any token, voucher or stamp contemplated in subsection (19)) is granted for a consideration in money, the supply of such token, voucher or stamp is disregarded for the purposes of this Act, except to the extent (if any) that such consideration exceeds such monetary value.

(19) Where any token, voucher or stamp (other than a postage stamp as defined in section 1 of the Postal Services Act, 1998) is issued for a consideration in money and the holder thereof is entitled on the surrender 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 the goods or services made upon the surrender of such token, voucher or stamp is regarded as nil.

(20) Where any token, voucher or stamp is issued by any vendor for no consideration and the holder thereof is entitled on surrender thereof to another person, being the supplier of goods or services, to a discount on the price of goods or services supplied to the holder, the consideration in money for the supply of such goods or services shall be deemed to include the monetary value stated on such token, voucher or stamp: Provided that such monetary value shall be deemed to include tax.