

25 NOVEMBER 2021

# TAX & EXCHANGE CONTROL ALERT

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### Forum shopping *in limine*: Tax Court redirects legality review to High Court

Chapter 9 of the Tax Administration Act 28 of 2011 (TAA) lays a path for taxpayers and the South African Revenue Service (SARS) to walk away from a dispute resolution where they encounter a dispute around the taxpayer's affairs. The TAA's dispute resolution process regulates the administrative engagement between SARS and the taxpayer at the point where a dispute about a decision by SARS arises.

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## Loyalty programmes: VAT clarified

There has always been a degree of uncertainty regarding the value-added tax (VAT) treatment of loyalty programmes, specifically where the loyalty points are issued and redeemed as part-payment for goods or services.

The number of loyalty reward programmes have increased drastically over the last few years. Although the programmes vary, the business rationale is more or less the same: they encourage sales, they aim to retain existing customers and attract new customers, and they assist businesses in monitoring spending trends so they can develop and implement focused marketing campaigns.

There has always been a degree of uncertainty regarding the value-added tax (VAT) treatment of loyalty programmes, specifically where the loyalty points are issued and redeemed as part-payment for goods or services.

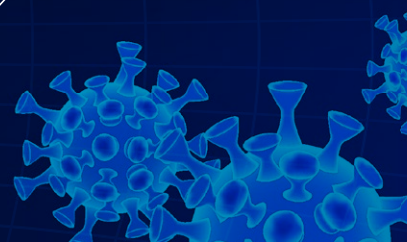
The South African Revenue Service issued Interpretation Note 118 (IN 118) on 4 November 2021 to clarify the VAT implications resulting from participation in points-based loyalty programmes. IN 118 does, however, not deal with loyalty points issued where such points are regarded as a discount on future purchases.

IN 118 specifies the characteristics of a loyalty programme as follows:

- membership to a loyalty programme is open to any customer or to the public as a whole;
- members are entitled to be allocated a reward in the form of loyalty points based on the value of goods or services acquired from certain entities;
- the member is not liable for any additional payment before becoming entitled to loyalty points, other than paying a membership fee, where applicable;
- members may in some instances pay less for goods or services than other customers, but they will not pay more;
- loyalty points allocated have a value attached to them, whether specific or notional; and
- the loyalty points can be redeemed by the member for goods or services with the value of the loyalty points as payment for goods or services.

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## Loyalty programmes: VAT clarified

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When a member makes a purchase of goods and services which results in loyalty points being awarded, VAT is payable at the applicable rate on the total sales consideration of such goods or services.

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IN 118 identified two main structures of loyalty programmes:

- **The exclusive programme** – which is administered in-house where the supplier is the only stakeholder to the loyalty programme.
- **The multiple entities programme** – where there are multiple loyalty partners involved. A customer becomes a member of the loyalty programme by entering into a membership agreement with a loyalty programme operator, which administers the programme. Various suppliers become partners to the loyalty programme. The member earns loyalty points on purchases made from loyalty partners. The member is then entitled to redeem the loyalty points on future purchases from a redemption partner.

### VAT implications

IN 118 explains the VAT implications of the various transactions under a points-based loyalty programme as follows:

- Any fee paid by a member to participate in the loyalty programme is subject to VAT.
- When a member makes a purchase of goods and services which results in loyalty points being awarded, VAT is payable at the applicable rate on the total sales consideration of such goods or services. The loyalty points are awarded for no consideration and the value on which VAT is payable is therefore nil.

- Any points fee which the loyalty partner pays to the loyalty programme operator equal to the monetary value of the points awarded, in a manner of monetising the loyalty points and falls outside the scope of VAT.
- When loyalty points are redeemed for goods or services, VAT is payable by the redemption partner on the total sales value of the goods or services, including the consideration settled by way of the redemption of the loyalty points.
- The settlement by the loyalty programme operator of the redemption cost with the redemption partner equal to the value of the loyalty points redeemed, comprises the payment of money which falls outside the scope of VAT.

IN 118 also sets out the VAT implications of related transactions as follows:

- Where loyalty points are sold to a customer for a consideration, such loyalty points comprise a voucher as contemplated by section 10(18) of the Value-Added Tax Act 89 of 1991 (VAT Act) (commonly known as gift vouchers). The sale of such vouchers is not subject to VAT but VAT is payable at the applicable rate when the voucher is redeemed for goods or services.
- The transfer of loyalty points between members has no impact on the VAT liability of the loyalty programme operator, the loyalty partner or the redemption partner.

## Loyalty programmes: VAT clarified *...continued*

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IN 118 achieves neutrality for all the participants concerned where the programme operates in the manner described in the interpretation note.

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- The awarding of loyalty points under an employment incentive scheme is not subject to VAT but constitutes a taxable fringe benefit for VAT purposes.
- The conversion of loyalty points in one programme into loyalty points in another programme comprises the redemption of the loyalty points in the first programme and the issue (sale) of loyalty points in the other programme. The sale of the loyalty points in the second programme comprises section 10(18) vouchers and therefore neither the redemption nor the sale attracts VAT.
- The expiry of loyalty points issued but not redeemed has no VAT implications.

IN 118 does not deal with the VAT implications of tokens, vouchers or stamps as contemplated by sections 10(18) and 10(19) of the VAT Act, as loyalty points are generally issued for no consideration. Accordingly, section 10(18) will only apply in instances where the loyalty points are issued for a consideration. IN 118 specifically states that section 10(20) vouchers, being vouchers issued for no consideration which entitles the holder to a discount of goods or services purchased from another vendor, do not apply in the context of points-based loyalty programmes that fall within the scope of the interpretation note.

IN 118 achieves neutrality for all the participants concerned where the programme operates in the manner described in the interpretation note. However, it should be noted that the interpretation note stipulates that where the loyalty programme operator reimburses the redemption partner an amount which is less than the value of the points redeemed, there is no deduction available to the redemption partner for the difference. In such case the redemption partner will pay VAT on a higher amount than the actual consideration received for the supply, which is contrary to the operation of the VAT system.

### Conclusion

IN 118 provides useful clarity on the VAT implications of points-based loyalty programmes. However, IN 118 does not deal with the VAT implications of loyalty programmes which operate in any different manner. It is therefore advisable to consider the VAT implications of the underlying transactions of loyalty programmes where they do not operate in the same manner as those described in IN 118.

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*Tersia van Schalkwyk*

## Forum shopping *in limine*: Tax Court redirects legality review to High Court

The taxpayer argued that under section 117(1) of the TAA the Tax Court has jurisdiction over tax appeals lodged under section 107 of the TAA.

Chapter 9 of the Tax Administration Act 28 of 2011 (TAA) lays a path for taxpayers and the South African Revenue Service (SARS) to walk away from a dispute resolution where they encounter a dispute around the taxpayer's affairs. The TAA's dispute resolution process regulates the administrative engagement between SARS and the taxpayer at the point where a dispute about a decision by SARS arises. Chapter 9 also prescribes the mechanisms available for resolving a tax dispute, as it is the statutory origin of the Tax Board, the Tax Court and the Tax Court Rules – including the opt-in alternative dispute resolution procedures.

On 19 October 2021, the Tax Court in Cape Town delivered its decision in *CSARS v FP (Pty) Ltd* Case Nos. 25330, 25331 and 25256. The matter involved SARS raising a challenge that a review of an additional assessment in the Tax Court was an irregular step. In deciding this challenge the judgment deals with the appropriateness of bringing a principle legality review in the Tax Court in the context of the dispute resolution provisions of the TAA.

### SARS' argument

SARS raised a challenge under Rule 30 of the Uniform Rules of Court to the taxpayer's attempt to challenge and set aside the additional assessments on application to the Tax Court in terms of a legality review. The basis for this was that the Tax Court is a creature of statute, with its jurisdiction and competence defined by the TAA.

SARS argued that where a taxpayer is aggrieved by an assessment, under section 104(1) of the TAA, they may lodge an objection and pursue the dispute. It argued further that a taxpayer may only deviate from the TAA dispute resolution procedure of following an appeal to the Tax Court if permitted to do so by a High Court in terms of section 105 of the TAA.

### The taxpayer's argument

The taxpayer argued that under section 117(1) of the TAA the Tax Court has jurisdiction over tax appeals lodged under section 107 of the TAA. Section 117(1) of the TAA reads:

*"117. Jurisdiction of the Tax Court (1)  
The tax court for purposes of this Chapter has jurisdiction over tax appeals lodged under section 107."*

Therefore, as the review arose in the context of an appeal under section 107 of the TAA, the Tax Court has jurisdiction to adjudicate the review. It relied on *South Atlantic Jazz Festival (Pty) Ltd v CSARS* [2015] (6) SA 78 (WCC), where it was held that:

*"The jurisdiction of the Tax Court to determine tax appeals is conferred without any limitation in section 117(1) of the TAA. The court must be taken to have been invested with all the powers that are inherently necessary for it to fulfil its expressly provided functions."*

The taxpayer further contended that it would be unfair, irrational and "create and undesirable dichotomy between the High Court ... and the Tax Court", if it had to pause the tax appeal proceedings and approach the High Court under section 105 of the TAA in a parallel litigation process.

## Forum shopping *in limine*: Tax Court redirects legality review to High Court

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As the taxpayer was bound by section 105 of the TAA to seek leave to bring the legality review, SARS was correct to raise a uniform Rule 30 challenge.

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### The decision

The court emphasised that SARS had brought a procedural challenge to the taxpayer's review, which as a point of law required a determination of the jurisdiction of the Tax Court. It distinguished the present facts from *South Atlantic Jazz Festival* on the basis that section 105 had been amended and that the taxpayer in that case was exercising its right of appeal to the Tax Court and not seeking to review SARS' administrative action. The court also noted that the taxpayer had conceded that the review application was not an interlocutory or procedural one launched under section 117(3) of the TAA which reads:

*"117. Jurisdiction of the Tax Court*

*(3) The court may hear and decide an interlocutory application or an application in a procedural matter relating to a dispute under this Chapter as provided for in the 'rules'."*

The crux of the decision of the Tax Court was based on section 105 of the TAA. It held that section 105 makes it clear that a taxpayer may only dispute an assessment or "decision" as described in section 104 in accordance with Chapter 9 of the TAA and the Tax Court Rules, unless a High Court directed otherwise.

Therefore, as the taxpayer was bound by section 105 of the TAA to seek leave to bring the legality review, SARS was correct to raise a uniform Rule 30 challenge, as the launching of the review proceedings in the Tax Court in these circumstances constituted an irregular step.

The court ordered that the review application be set aside and stayed the appeal proceedings in the Tax Court pending the determination of the review application to be launched in the High Court by the taxpayer.

### Comment

This case provides a good illustration of the scope of the Tax Court to determine tax disputes. The design of the dispute resolution process under the TAA requires taxpayers to participate within its structures unless the High Court determines that there are grounds for departing from that procedure.

Preventing the parallel jurisdiction of the High Court at the primary appeal stage of the TAA dispute resolution system enables the TAA's specialised dispute resolution system to function in a contained environment.

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**Tsanga Mukumba**

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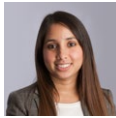
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