



TAX

Taxation of Rewards Points

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It has become common for businesses to implement loyalty programmes in order to incentivise their customers. These programmes allow customers to earn points by, for example, swiping their credit card, going to gym or making a purchase. Once the customers have accumulated enough points, they can redeem these points for discounts, free products or even cash. In this article, we consider whether SARS is entitled to a slice of the pie.

The starting point is to determine whether a person who earns rewards points should pay income tax on the value of these points, which will generally be the case if the points are revenue in nature (as opposed to capital in nature).

Broadly speaking, revenue is what a person earns through his work or wits, or the employment of his capital. Amounts which arise fortuitously, rather than being deliberately sought for and worked for, are regarded as capital in nature. For example, the recipient of a birthday gift is not liable for income tax thereon, because that gift was not sought for or worked for and is therefore capital in nature.

Whether the rewards points received by a customer are classified as capital or revenue will depend upon the facts. In most cases, rewards points are merely a perk – a welcome but incidental consequence of an activity which the customer would have performed regardless. In these situations, SARS would be hard pressed to argue that the points are the product of a revenue producing activity.

On the other hand, there are some cases where customers make a concerted effort to seek out customer loyalty programmes and tailor their shopping accordingly. Depending on the nature and extent of the customer's activity, rewards points may be revenue in nature and subject to income tax if the customer has crossed the Rubicon and embarked upon a profit-making scheme involving rewards points.

If the rewards points earned by a customer are capital in nature, and therefore not subject to income tax, consideration should be given to whether these points could be regarded as capital assets which are disposed of when they are redeemed or cashed in, and if so, whether such disposal could give rise to tax.

In essence, a reward point is a personal right which the customer holds against the issuing company, entitling him or her to claim the relevant benefit. There are some cases where the disposal of a personal right will give rise to tax, for example, the sale of a share (which is nothing more than a bundle of personal rights which the shareholder holds against the relevant company). However, there are also many cases where the disposal of a personal right will not trigger tax. For example, consider the sale of a house. The seller disposes of his house in exchange for an agreed-upon purchase price, but before the seller gets the purchase price in cash, he gets a personal right against the purchaser to claim payment of the purchase price. When the purchaser makes payment, the seller exchanges his personal right for cash. If the latter transaction were to be treated as a tax event, the seller would have to disclose two disposals: (1) the disposal of his house and (2) the disposal of his right to claim payment. However, SARS acknowledges in its Comprehensive Guide to Capital Gains Tax that, in such a case, the extinction of the seller's personal right against the buyer in exchange for the purchase price will not constitute a disposal of an asset for tax purposes.

Ultimately, when determining whether the disposal of a personal right will trigger tax in any given scenario, a common-sense approach should be adopted (see *Zim Properties Ltd v Proctor* (1984) 58 TC 371, quoted by SARS with approval in its Comprehensive Guide to Capital Gains Tax). The question in this case is whether common sense dictates that, when rewards points are redeemed, there is no separate disposal of an asset which could trigger tax, or whether the better and more sensical analysis is that the accrual of rewards points and their redemption constitute two separate transactions.

Rewards points derive their value exclusively from the fact that they can be redeemed. This is an inherent characteristic which is embedded in the rewards points from inception. Without this quality, they would be useless or without value – in fact they would likely cease to exist. Simply put, rather than providing their holders with an income return or capital growth, rewards points mature into cash, or some other benefit, in accordance with their natural lifespan. On this basis, it could certainly be argued that the redemption of rewards points is not a separate tax event, but rather forms part of the same overarching transaction in terms of which the points accrue. To conclude otherwise may bring about a number of unintended and impractical results (for example, tax would be payable in respect of every "buy one get one free" deal).

Given the rising popularity of customer loyalty programmes, we encourage taxpayers to consider the tax implications of the receipt and redemption of rewards points and seek advice in this regard, lest they be caught unawares.

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