

TAX

The Constitutional Court rules on tax allowances for retail loyalty programmes

2 June 2021 8 min read

It is rare to see tax disputes end up in the Constitutional Court and even more so to see two matters heard by the Constitutional Court within a space of approximately ten months relating to the very same section of the [Income Tax Act \(ITA\)](#).

This is precisely what happened in the cases of *Big G Restaurants (Pty) Ltd v Commissioner, South African Revenue Service* handed down on 21 July 2020 and *Clicks Retailers (Pty) Limited v Commissioner for the South African Revenue Service* handed down on 22 May 2021 which both considered the application of section 24C of the ITA. The similarities do not stop here as in both cases the appellant was the taxpayer.

This matter under consideration in the *Clicks* case concerned the tax treatment of retail loyalty programmes that are common in South Africa and whether an allowance under section 24C of the ITA was available to Clicks in respect of its future expenditure under the loyalty programme.

Briefly, the nature of a taxpayer's business may be such that the taxpayer receives amounts under a contract that will be used to finance expenditure to be incurred in the future in performing under that contract. The typical example is in the construction industry where the contractor receives an upfront payment under the contract before any construction work has begun. An anomaly arises when the income is received in one year and the expenditure is incurred in a subsequent year of assessment. Section 24C was inserted in the Act as a relief measure to taxpayers in that it provides an allowance for future expenditure which has yet to be actually incurred. In the absence of section 24C the income would be fully taxable in the year received without any deduction for future expenditure.

Taxpayer section 24C(2) allowance

In order for a taxpayer to claim a section 24C(2) allowance, three basic requirements must be met. There must be:

(1) income earned by a taxpayer in terms of a contract (the income-producing contract); (2) an obligation on the taxpayer under a contract that requires future expenditure, which will be financed by this income (the obligation-imposing contract); and (3) contractual sameness (see *Big G* below).

The Clicks ClubCard programme (loyalty programme) provided participating customers with loyalty points for shopping at Clicks that could be translated into cash-back vouchers, which are not redeemable for cash, but which may be off-set against the cost of Clicks' merchandise, provided that the customer accumulates the requisite number of loyalty points within a qualification period (this is typical of many such loyalty programmes). A separate written contract is concluded with the customer when he or she applies to join the loyalty programme and is accepted.

Clicks contended that when a loyalty programme member makes a purchase above a stipulated value threshold at a Clicks store and presents his or her ClubCard at checkout, a contract of sale is concluded and income accrues to Clicks. By doing so, the member earns loyalty points which can later be redeemed for Clicks merchandise. This imposes an obligation on Clicks to finance future expenditure, as envisaged in section 24C, in that it must later give away (for no further consideration) stock to the value of the loyalty points when the points are redeemed. This redemption takes place when the member enters into a further contract of sale and receives discounted merchandise purchased in terms of that further contract (redemption contract). It was on this basis that Clicks claimed a section 24C allowance for the 2009 tax year.

Pursuant to an audit, SARS disallowed Clicks' claim to an allowance in terms of section 24C(2) of the ITA on the basis that the income and the obligation to finance future expenditure arose from different contracts.

The argument presented to SARS by Clicks was that when a participating customer joins the loyalty programme, a "composite contract" comes into existence. This contract, which is "indivisible by nature", is constituted by the ClubCard contract and a contract of sale entered into by a member who presents his or her ClubCard at the time of the transaction. The contract of sale is "a performance requirement" in terms of the ClubCard contract to the extent that if a customer does not conclude a sale contract, the loyalty programme is rendered a nullity. It followed, according to Clicks, that the contract of sale cannot be viewed as an independent contract for purposes of the loyalty programme.

The taxpayer in this instance was successful with this argument in the tax court but lost in the Supreme Court of Appeal (SCA). The taxpayer was granted leave to appeal to the Constitutional Court.

Appeal to the Constitutional Court

As a starting point, the Constitutional Court must, in each matter, determine whether the matters that are placed before it falls within its jurisdiction before considering the legal merits.

The taxpayer argued that the matters raised an arguable point of law of general public importance. The point of law being the interpretation to be given to section 24C and the general public importance is the relevance to all other retailers who offer similar loyalty programmes. Examples of such retailers that were given are Pick n Pay, DisChem, Ster Kinekor and Exclusive Books. The taxpayer was successful in its arguments that the matter fell within the jurisdiction of the Constitutional Court.

Turning to the merits of the dispute, reference was made throughout to the SCA and Constitutional Court decisions of *Big G*. Here the Constitutional Court held that a section 24C allowance may be claimed provided the contract in terms of which the income that is to finance future expenditure is received is also the same contract under which the obligation to finance future expenditure arises (ie the "sameness requirement"). However, it also held that two or more contracts may be so inextricably linked that they may satisfy this requirement of "sameness". However, on the facts of that case, there was a lack of correlation between the income-producing sale of food contracts and the obligation imposing franchise agreements, which meant that they did not meet the sameness required by section 24C.

The Constitutional Court stated that Clicks' focus on whether the loyalty programme contracts are inextricably linked was based on a misunderstanding of the approach in *Big G*. What was said in *Big G* is that the taxpayer must show that the inextricable link between two contracts is such that the contracts meet the section 24C(2) *sameness* requirement. The Constitutional Court stated that this does not render the "inextricable link" factor irrelevant because clearly if the contracts are not inextricably linked to each other, the criterion of sameness is not likely to be satisfied. However, a finding that the sale contract and ClubCard contract are inextricably linked will not be the end of the matter. The determinative question is whether they are so inextricably linked that they satisfy the requirement of sameness.

In a unanimous judgment, the Constitutional Court held that there was an inextricable link between the sale contract and the ClubCard contract to the extent that both contracts operate together to give effect to Clicks' loyalty programme. However, in respect of the "sameness" requirement it was held that at a minimum both the earning of income and the obligation to finance future expenditure must depend on the existence of both contracts. If either contract can be entered into and exist without the other, they can hardly achieve sameness. Accordingly, the Constitutional Court found against Clicks on the basis that the contract under which income accrues (the contract of sale) and the contract under which the obligation to finance future expenditure arises (the ClubCard contract) while inextricably linked are simply too independent of each other to meet the requirement of contractual sameness.

A possible example of sameness in two contracts might be where an umbrella contract is concluded between parties in which the client agrees to acquire the services of the service provider for a project, for a gross fee, and the contract envisages that further contracts dealing with the various phases or the project will be separately concluded, including how much of the gross fee is allocated to that phase.

Interestingly, in the SARS Interpretation Note 78 of 29 July 2014 dealing with section 24C it is noted that "*in some situations it may be very difficult to analyse the future expenditure and link it to a particular contract. There is an obligation to perform under the particular contract and accordingly incur expenditure, however, there may be practical difficulties associated with being able to analyse the expenditure in sufficient detail to be able to link it to a particular contract. In these situations, if the contracts are similar and the taxpayer has the same obligations to perform under those contracts then, when calculating future expenditure, the contracts may be grouped together and the taxpayer may combine the advance income and expenditure*".

There is no indication in the judgements that Clicks sought to rely on the Interpretation Note. Perhaps there is an argument that the Interpretation Note could have been used by the taxpayer as so-called practice generally prevailing which would have prevented SARS from raising an additional assessment that is at odds with the aforementioned interpretation.

by Ryan Killoran, Director

For up to date tax advice, explore our [Tax practice area](#).



Ryan Killoran

Director

[View Profile](#)