Implications of ConCourt ruling for all loyalty programme providers

By Joon Chong

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The Constitutional Court recently handed down judgment on the *Clicks Retailers (Pty) Ltd v CSARS* case, which has wide ramifications for all loyalty programme providers. Loyalty programme future expenditure will as a result, be claimable only if the obligation for such expenses is imposed in the same income-producing contract.

Section 24C of the Income Tax Act 58 of 1962 allows a deduction of future expenses if income received in the year of assessment places an obligation on the taxpayer to incur the future expenses in terms of the same contract. Section 24C has three requirements:

- income earned by a taxpayer in terms of a contract (the income-producing contract);
- an obligation on the taxpayer that requires future expenditure which will be financed by this income (the obligation-imposing contract); and
- contractual sameness of the above.

Clicks had claimed a section 24C allowance for future expenditure which will be incurred on its ClubCard loyalty programme. The Sars Commissioner rejected the claim and Clicks appealed to the Tax Court, which found in favour of Clicks. The matter was subsequently referred to the Supreme Court of Appeal (SCA) and then to the Constitutional Court.

The importance of the Constitutional Court's judgment is that it expanded on the meaning of "contractual sameness" which had been decided on in a 2018 judgment on section 24C. In *Big G Restaurants (Pty) Ltd v CSARS*, the Constitutional Court confirmed that the income-earning and obligation-imposing contract should be literally the same contract; or sourced in two or more contracts that are so inextricably linked that they meet the requirement of sameness.

Clicks relied on the contract of sale as the income-producing contract. Clicks argued that the income from this sale contract is used to finance future expenditure in the performance of its obligation to redeem loyalty points and hand over discounted merchandise for a ClubCard customer. When a customer signs the ClubCard contract, a "composite contract" consisting of the income-producing sale contract, and the ClubCard obligation-imposing contract comes into existence. These two contracts are "inextricably linked" because they operate together. The obligation to award points governed by the terms of the ClubCard contract is only triggered and given content when a qualifying purchase is made in terms of the sale contract.

The Tax Court ruled in Clicks' favour. It held that the income-earning sale contract and the obligation-imposing contract to incur future expenditure were inextricably linked.

However, on appeal, the Supreme Court of Appeal (SCA) rejected this approach. It confirmed the principles articulated in the Big G judgment. The SCA held that the sale contract was the income-producing contract, and the obligation-imposing contract was the ClubCard contract. These were two separate and distinct contracts, which meant Clicks did not meet the "contractual sameness" requirement.

The Constitutional Court held in the appeal on the SCA judgement that the sale contract and the ClubCard contract were inextricably linked. The contract of sale provides the specificity and content to the terms of the ClubCard contract, effectively establishing the specific ambit of the obligation incurred by Clicks.

However, the court found that these two contracts do not meet the requirement of sameness for these reasons.

- The two contracts are independent of each other. The existence of one does not depend on the existence of the other. Sameness is achieved when each contract cannot be entered into and exist without the other.
- The obligation-imposing contract (ClubCard contract) does not depend on the existence of the income-producing sale contract. This is particularly the case where Clicks has agreements with affinity partners or third-party merchants such as Discovery, NetFlorist or Nu Metro. Purchases made by a ClubCard holder from these suppliers would give rise to an obligation on Clicks to incur future expenses in terms of the ClubCard contract. However, there is no corresponding income earned from a sale agreement for Clicks. (On this point, the Commissioner had argued that this in effect breaks the link between the income and expenditure contract, as income accrues to the affinity partner. Yet Clicks is obliged to finance the future expenditure.)
- Likewise, the sale contract does not depend upon the ClubCard contract for its existence. Clicks continues to earn income from the sale of products and services to non-ClubCard members, and this is not because Clicks agrees to provide discounts to ClubCard members based on their points earned.
- The terms of the sale contract are the same for ClubCard customers and non-ClubCard customers.
- Both contracts function independently and are complete contracts on their own. The terms of one contract exist independently of the other. The generation of income is not regulated by the ClubCard contract, and no aspect of the sale contract is dictated by the ClubCard contract.

Accordingly, the Constitutional Court found that the ClubCard's future expenses do not qualify for the section 24C allowance.

There has been an increase in tax audits and disputes relating to section 24C since the Big G SCA decision. This judgment has further clarified the section 24C requirement of "sameness", and how difficult it is to meet this requirement. The impact of the decision is not good news for loyalty programme providers - loyalty programme future expenditure will now only be claimable if the obligation for such expenses is imposed in the same income-producing contract. This is very restrictive.

Notably, however – there may be scope for a counterargument - the *Interpretation Note 78 Allowance on future expenditure*, which was issued by SARS on 29 July 2014 (IN 78), discusses claiming the allowance in contracts such as gift vouchers and warranty contracts. An interpretation note is an official publication which is a practice generally prevailing. For certain types of contracts, there is perhaps scope to argue that SARS is precluded from issuing an additional assessment on the basis of the IN 78 being the practice generally prevailing at the time of the original assessment.

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