# When should revenue for gift cards be taxable?

By Joon Chong

25 Oct 2019

The recent Tax Court (Cape Town) judgement of IT 24510 confirmed that amounts received by a retailer for the sale of gift cards were not "received or accrued" for purposes of the gross income definition. The taxpayer had not included proceeds from the sale of gift cards as gross income in the year the gift cards were sold, which resulted in the additional income tax assessment and dispute. The court held that the taxpayer had correctly accounted for the value of the cards as gross income on the earlier of the year when the cards were redeemed, or expired. Based on the court's reasoning, it is submitted that there are strong grounds to argue that there is also no liability to account for value-added tax on the same basis, i.e. not when the cards are sold but when they are redeemed or on expiry.


The taxpayer had, until 2013, declared all revenue from the sale of gift cards as part of its gross income in the year such revenue was received. However, when the Consumer Protection Act 28 of 2011 (CPA) came into operation on 31 March 2011, the taxpayer changed the tax treatment of such revenue.

The CPA (sections 63 and 65) changed the legal position of "a prepaid certificate, card, credit, voucher or similar device" which can be exchanged for goods or services. As a result of the CPA, the taxpayer's gift cards would not expire until the earlier of the date when (i) the full value was redeemed; or (ii) three years (unless extended by agreement). Unredeemed amounts of unexpired gift cards are the property of the bearer of the cards. Notably, the taxpayer must not treat any unredeemed amounts as the property of the taxpayer. The taxpayer must exercise due care, diligence and skill in managing the unredeemed amounts, and is liable to the owner of the amounts for any loss. Should the taxpayer become insolvent, the administrator, executor or liquidator of the estate (i) has a duty to the owner to determine the existence of the unredeemed amounts; (ii) has a duty to ensure that such amounts are dealt with for the owner's benefit; and (iii) could be liable to the owner for any loss unless they acted in good faith and without knowledge of the owner's interest in the unredeemed amounts.

The court held that merely segregating the revenue on the sale of the gift cards into a separate banking account does not mean that the taxpayer was holding such amounts in trust for the consumer / owner and had not received the amounts for its own benefit. The taxpayer had not received the amounts for its own benefit because the CPA had created a form of statutory trust for the revenue. The taxpayer had a fiduciary duty to the bearer of the card to ensure that the funds are kept available until the prepayment is redeemed. The purpose of the creation of the statutory trust (which is a legal fiction) is to ensure that bearers of gift cards would still be able to recoup the full value of the unredeemed portions even when the supplier of the cards is sequestrated or wound-up before the cards are redeemed.

The court noted the conceptual difficulty of such revenue being deemed to be the property of the bearer of the cards in terms of the CPA as the revenue had intermingled with the taxpayer's other receipts (received for its own benefit). Money is fungible or interchangeable in the law of property. This means that the taxpayer became the legal owner of such revenue when the moneys were mixed with its other receipts. On this, the court adopted an interpretation that gives effect to the purpose of the CPA. The court held that the monthly reconciliation and transfer of the unredeemed card receipts to the segregated funds account imply that the affected monies are identifiable and traceable in the taxpayer's accounting system. Therefore, there should be no difficulty with the practical identification of "trust money" from the moment they are received in the taxpayer's hands.

The Commissioner for the South African Revenue Service had also argued that the purpose of the CPA was to protect consumer rights and not to defer liability for income tax. The gross income inclusion for income tax is not subject to any other legislation unless specifically provided otherwise in the Income Tax Act. The court disagreed and held that if factually, the CPA provides that there is no beneficial receipt of such revenue by the taxpayer, then it follows that there is also no receipt in the context of "taxable income".

The terms and conditions of many types of commercial prepayments or deposits provide that the rights to such amounts remain with the account holder, payer or bearer. This is recommended as they support the tax position taken that the recipient has not received the amounts for their own benefit (and thus need not be included in gross income). This is also in line with the CPA and the principles of this judgement. What would be reassuring for suppliers is also the court's acceptance of the monthly reconciliation and segregation of such amounts as a method to enable segregation of the receipts as "trust money". In large scale retail operations, it is probably not practical to separate these transactions in any other manner or more frequently.

## ABOUT THE AUTHOR

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