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Avoiding tax in South Africa's retail industry via customer loyalty programs

Karen Odendaal [a*], Teresa Calvert Pidduck [a]

[a] Department of Accountancy Studies; School of Business and Economics; Monash University, South Africa.
[*] Corresponding author's email address: karen.odendaal@monash.edu

HIGHLIGHTS:

1. This study aims to identify the fiscal leakages occurring as a result of the implementation of customer loyalty programmes.
2. The effect of the fiscal leakage is scrutinized from the perspective of the retail sector in South Africa.
3. The financial impacts of the fiscal leakages have been determined for business cases in the retail sector.
4. The article examines different taxation implications and recommends a method of taxation for customer loyalty programmes.

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ABSTRACT

The Medium Term Budget Policy Statement presented by the South African Minister of Finance in late 2013, highlighted that government expenditure substantially exceeded revenues collected. In investigating the possible broadening of the South African tax base as well as improving revenue administration, there is evidence of a gap in the taxation of customer loyalty programmes within many industries. The problem is that customer loyalty award credits are currently not being taxed by the revenue authority in South Africa. This study uses a multiple instrumental case study design to identify the tax leakages resulting from inadequate revenue administration within the South African retail industry's use of customer loyalty programmes. The study has found that the loss to the *fiscus* in the non-taxing of customer loyalty award credits is substantial.

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1.0 Introduction

Customer loyalty programmes (CLP's) are designed by companies to give customers rewards for remaining loyal to that company or supporting the company that provides the reward rather than a company that does not provide any rewards. CLP's are not only beneficial to consumers, but also to businesses and the economy as a whole for many reasons. Consumers who belong to CLP's gain benefits through discounts, cash-backs or free/discounted goods or services. Companies reap benefits through reduced marketing cost, increased spending by their customers and brand loyalty, as well as gaining non-financial benefits by obtaining an understanding of their customers' spending habits in order to increase service delivery (Chinomona and Sandada, 2013). This further allows companies to make adjustments to their product and service offerings to suit their customers' needs. CLP's also have a role to play in the economy, due to the fact that spending of award credits by customers increases purchasing power and contributes to the gross domestic product of the country as a whole (Bizcommunity, 2012).

There are many CLP's in the South African market and many of the providers of these CLP's and their related benefits have grown tremendously over recent years. Recently research has revealed that the market for CLP's have enjoyed astonishing growth in South Africa over the past decade (Kearney, 2013). CLP's have grown from a few loyalty cards offering air miles to burgeoning to over 15 million people having the ability to choose from more than 80 CLP's (Kearney, 2013). According to Bruggemans and Duvenhage customers are exploring ways to use CLP award credits and are spending more of their CLP benefits on necessities (rather than luxuries) during difficult and turbulent economic times (Bizcommunity, 2012).

The face of the economic transactions with regards to CLP's occurring in South Africa has drastically changed the manner in which both businesses and consumers interact. This change has been catered for within international accounting standards, but no such change has been made on the part of the South African revenue authority. This indicates that there might be a gap in the taxation of CLP's within many industries, which allows beneficiaries to receive tax-free customer loyalty rewards whilst costs associated with these programmes are deducted by businesses providing these rewards. In addressing this disparity, the South African Revenue Service may be able to increase the tax base by implementing a tax on the receipt of customer loyalty award credits which are currently not taxed in South Africa, with the view of increasing much needed government revenues. For this reason any gaps in the taxation of the currently tax-free customer loyalty award credits is of interest to any researcher, taxpayer and government interested in understanding where current administration of legislation may be failing. The largest concern in the view of the authors is that stagnant administration by the revenue authority is resulting in inadvertent tax avoidance by customers in the retail industry with regards to the receipt of non-taxed award credits.

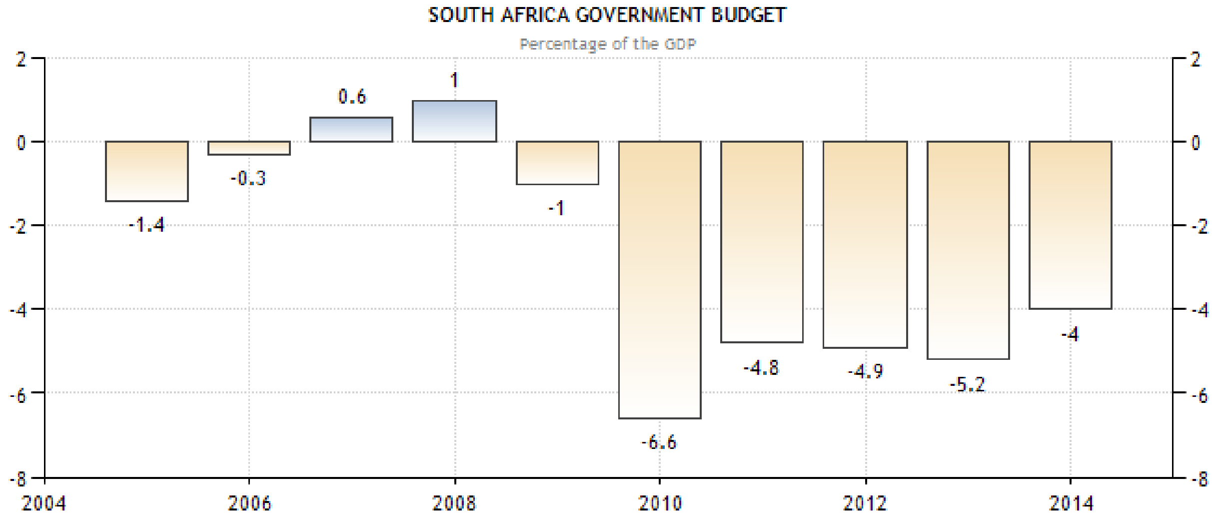
This paper will set out the theoretical framework in section 2.0 on which the research problem and objectives are based, discuss the research methodology and results under section 3.0 and 4.0 respectively, and conclude in the last section.

2.0 Theoretical framework & research gap

The importance of reducing tax leakage in South Africa was highlighted by the South African Minister of Finance in both the 2013 Budget Speech and the Medium Term Budget Policy Statement, where it was noted that government expenditure had substantially exceeded revenues and minimizing tax leakages and disparities within the *fiscus* is an area of priority, in light of creating a sustainable fiscal policy (National Treasury, 2013a; 2013b). It is therefore necessary to address any area of tax avoidance and adapt taxation policy and systems to any changes in economic environment to avoid a shortfall in public spending requirements in a growing economy. This concern is not limited to the South African context and amendment of tax legislation is in fact a worldwide concern, so that the burden of paying for public spending is fairly distributed (Bird, 2008). It is recognized globally that taxes are necessary to finance public spending and collection of taxes provides a way of ensuring that the burden of paying for such public spending is fairly distributed (Bird, 2008). However, tax policy should also incorporate fairness and should not just be about fiscal spending (Bird, 2008). Fairness in *fiscal* policy cannot be achieved if the tax rules and regulations cannot keep pace with the rapidly changing economy. If the *fiscal* policy does not accommodate economic changes fast enough, this will increase economic distortions or simply become sidestepped by market innovations and technology (Cockfield, 2006; Neubig & Poddar, 2000). The global concern of not adapting tax policy to allow for changes in the economic environment raises a major question regarding the ability of governments to adapt their tax systems to the new economy.

When commenting on the fairness of fiscal policy in developing countries, most fiscal experts propose reforms which are as broad as possible so that all incomes, no matter the source, should be treated as uniformly as possible. This is often done on the premise that developing economies should strive to broaden bases, lower tax rates and improve administration (Barreix and Roca, 2007; Bird, 2008; Broadway, 2005). It is thus evident that the importance of fairness in tax policy is crucial in any economy and, economic distortions resulting from inadequate fiscal policy undermines the ability of the government to collect taxes in a just manner, further allowing market innovations and technology to sidestep the integrity of the tax system (Bird, 2008; Cockfield, 2006; Neubig and Poddar, 2000). In addition to this, delayed responses to changing economic transactions effectively allows taxpayers to legitimately react by arranging their affairs to minimize tax liabilities, further frustrating the essence of fiscal fairness (Neubig and Poddar, 2000; Rose, 1985). The reform of tax systems and related policy should focus on achieving this fairness, with the hope of realising sustainable economic growth despite the daunting nature of policy amendment (Katz, 1996).

In the light of much needed *fiscal* revenues in South Africa, the graph below highlights the South African government budget trend over the last 10 years (Trading Economics, 2014):



Based on the clear need to increase the tax base and reduce tax leakage in South Africa, this study thus examines the impact on the *fiscus* in South Africa as a result of the revenue authority not identifying or addressing inadvertent tax avoidance relating to CLP's. In not addressing tax avoidance of this nature, it impacts on the ability of the South African government to finance public spending in a growing economy. In light of the fact that CLP award credits are not currently being taxed, this paper researches the question of adapting legislation and administration in South Africa, specifically with regards to amending revenue collection in line with the changing economic environment in respect of CLP's, as well as whether the loss to the *fiscus* in not adapting to the economic change might be substantial.

In addressing the taxation of CLP's, any amendment to fiscal policy should not place an unreasonably high tax burden on CLP award credits so that the numerous benefits of CLP's are negated. Similarly, any changes to fiscal policy should be as simple and easy to implement as possible in order to reduce the amount of investment of scarce time and resources (Calvert, 2012). Identifying a method of taxation which caters for all of these concerns would be the most advantageous to the South African economy, as well as fast-tracking a tax collection on CLP award credits without undue delay. Minimizing tax leakage and disparities within the South African *fiscus* whilst increasing the tax base has been identified as an area of priority in light of creating a sustainable fiscal policy (National Treasury, 2013a; 2013b). For this reason any gaps in the taxation of the currently tax-free CLP award credits is of interest to any researcher, taxpayer and government interested in understanding where current administration of legislation may be failing. This study identifies the tax leakages resulting from inadequate revenue administration within the South African retail industry's use of CLP's. Proposed solutions to this problem that cater to the needs of government, businesses and consumers have also been identified so that the use of CLP's remain a viable tool for business in South Africa, whilst maintaining the fairness sought for fiscal policy.

The research objectives to be pursued in addressing the goal of the research can be formulated as follows: (a) to identify the fiscal leakages occurring as a result of the introduction of CLP's in South Africa in the retail industry; (b) to recommend a method of taxation of CLP award credits for the retail industry; (c) to determine the financial impact of the recommendation in the retail industry in South Africa.

3.0 Research design and methodology

This study uses a qualitative research paradigm in the form of a multiple instrumental case study (Stake, 2005). This design was selected to identify patterns, relationships and the dynamics of the CLP's currently used within the South African retail industry by focusing on one issue as well as its different fiscal perspectives (Creswell, 2007; Henning, Van Rensburg and Smit, 2004). By using industry case studies the researchers are able make comparisons, build theory, or propose generalizations regarding the fiscal implications and tax leakages resulting from outdated tax administration (Leedy and Ormrod, 2005). The use of documentation in the form of archival records including the annual financial statements ("AFS") allows the researchers to investigate the financial impact of the problem for the *fiscus* (Hesse-Biber and Leavy, 2011). The industry specific cases thus form a microcosm of a larger system and indicate symptoms present within the retail industry as a whole (Gomm, Hammersley and Foster, 2000). Though the study is South African specific, it may provide useful insight to other jurisdictions/countries.

Though CLP's have been introduced by a number of sectors such as air travel, hotel and restaurant industry and the retail industry, CLP's in the retail industry have only recently started to come to the fore (IFRS Foundation, 2011; Kearney, 2013; Maharaj, 2008). Although there has been large growth in CLP's over the last decade, most CLP's in the retail industry are in their infancy and an opportunity exists for many other companies to implement successful CLP on the basis of these models (IFRS Foundation, 2011; Kearney, 2013; Maharaj, 2008). For the purposes of this study, businesses in the retail industry that operate and disclose information about CLP's were selected, as predominant growth in CLPs have occurred in this industry and their importance to the South African *fiscus* is critical (Moorad, 2013). The companies selected were those listed in the retail industry from the Bloomberg Markets' financial database and all the AFS were inspected to determine if they disclosed and reported a CLP (Bloomberg Markets, 2013). The study is limited to those CLP award credits supplied in the form of loyalty points awarded by the retail company. However, this does not include CLP award credits provided to customers in the form of immediate discounts or CLP award credits awarded by third parties.

Two retail companies had sufficient financial disclosures regarding the CLP's operated in their organizations, namely Pick 'n Pay Holdings Limited ("PnP") and Clicks Group Limited ("Clicks"). The authors are aware that there are more companies in the retail industry that offer CLP's, but with insufficient disclosures these companies could not form part of the study. This occurred predominantly because these companies often offered cash discounts at the check-out point or retail partners belonging to an outside third party CLP and no disclosures are required for these types of CLP's in terms of IFRIC 13 (IFRS Foundation, 2011). The selection of Clicks and PnP within the South African retail industry thus suits the aim of the study.

4.0 Discussion

In the 2013 Budget Speech and the Medium Term Budget Policy Statement, the South African Minister of Finance highlighted that government expenditure substantially exceeded revenues collected (National Treasury, 2013a; 2013b). The slow rate of growth experienced in South Africa's economy resulted in a revenue shortfall of R16.3 (average USD/ZAR exchange rate for September 2014 is USD 1 = ZAR 10.68) (Oanda, 2014) billion which is estimated to be 5.2 per cent of GDP in 2012/13 (National Treasury, 2013a). In light of this economic pressure on government, it is evident that government will need to reconsider current expenditure and revenue growth plans in order to find an appropriate balance between spending restraint and new revenue initiatives (National Treasury, 2012). The Minister of Finance supports the presumption that growing the economy and increasing the tax base necessitates the generation of new resources and revenue initiatives (National Treasury, 2013a). In the past, the increase in the tax base in South Africa has been made through policy reforms and improved revenue administration, but this is an ongoing process where improvements can constantly be made (National Treasury, 2013a). The authors have identified that the taxation of CLP award credits is one area where the broadening of the tax base may be made with relative ease. as whilst the receipt of CLP award credits are not currently included in the income of taxpayers, the costs associated with providing these credits are deducted in determining the taxable income for the providers of the award credits (Pidduck and Odendaal, 2013).

4.01 CLP's in the retail sector

In the retail industry, loyalty cards usually allow customers to collect points through the use of a loyalty card and when a customer has collected a certain number of points, the customer is entitled to collect a reward (Maharaj, 2008; Rowley, 2000). These rewards often include immediate cost savings, member-only deals, rebates, cash back drawings and contests which all have some monetary value to the customer (Allaway, Gooner, Berkowitz and Davis, 2006; Maharaj, 2008).

This study is limited to CLP programmes offered by retail companies which allow customers to redeem their CLP award credits on future purchases. In most instances these CLP award credits are managed by the company itself and the award credits can only be redeemed at the specific retailer where the CLP award credits were earned. The mechanics of the CLP award credits earned at both PnP and Clicks are described diagrammatically below:

Figure 01: PnP

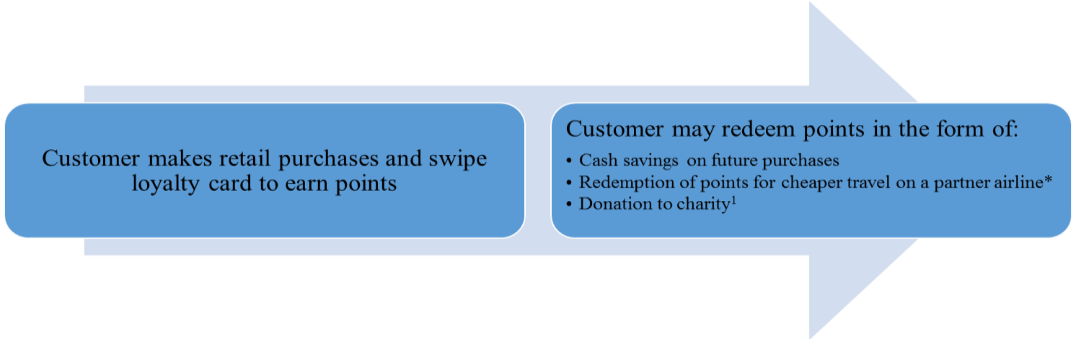
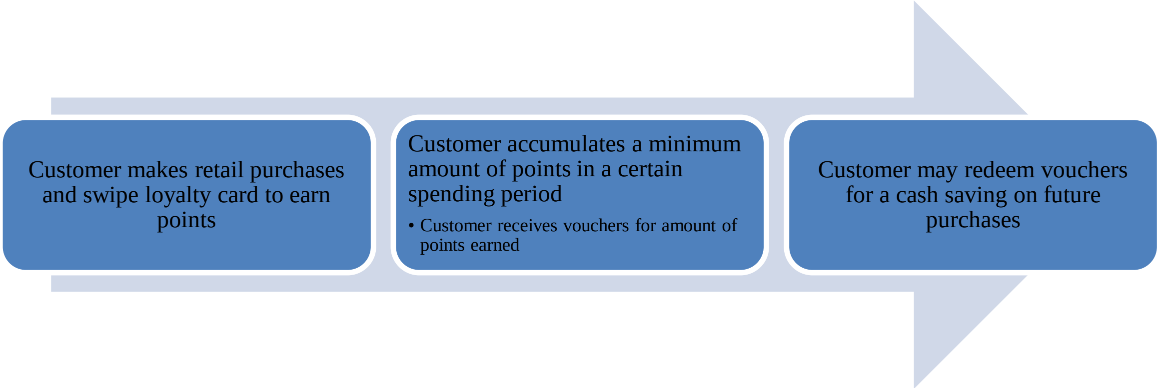


Figure 02: Clicks CLP



From the perspective of the retailer, both of these CLP's work in a similar manner as the retailer is providing a benefit in the form of cash discounts (or in the case of PnP a cash donation to a charity of the customer's choice or a cash discount towards flights) in return for spending money on the retailers' goods. The customers therefore earn award credits from a specific retailer for spending at that specific retailer.

In order to analyze the financial data reported by these two retailers, it is important to understand how these CLP's have been accounted for in their respective AFS. The accounting treatment of CLP's is governed by the International Financial Reporting Interpretation Committee ("IFRIC") 13. IFRIC 13 applies to CLP award credits that are granted to a customer as part of a sale transaction where the customer may redeem the award credits for free or discounted goods/services (IFRS Foundation, 2011). PnP and Clicks should therefore be accounted for as prescribed in IFRIC 13. The accounting treatment provides that a company should account for award credits as a separately identifiable component of the initial sale transaction. In doing so, the consideration from the initial sale should be apportioned between the award credits and the sale of the goods (IFRS Foundation, 2011). The company will therefore recognize revenue immediately upon the sale of the retail item, but a portion of the consideration relating to the fair value of the CLP award credits, should be accounted for as deferred revenue and only recognized once the CLP award credits are redeemed by the customer. In determining the amount of revenue relating to the award credits to be deferred, the company is required to measure the fair value of the award credit with reference to the amount of the discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale after taking into account expected forfeitures (IFRS Foundation, 2011).

In order to gain a greater understanding of the accounting treatment of the initial and deferred revenues as disclosed in the AFS, the authors have provided an illustrated example below (IFRS Foundation, 2011):

Example 01—Awards supplied by the entity

A grocery retailer operates a CLP. It grants programme members 1 loyalty point for every R10 they spend at the retailer. CLP members can redeem the points for cash discounts on future groceries. The points have no expiry date. In one period, customers spend R1 000 and the entity grants 100 points. Management estimates the fair value of groceries for which each loyalty point can be redeemed as R1.25. This amount takes into account an estimate of the discount that management expects would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management expects that only 80% of these points will be redeemed. Therefore, the fair value of each point is R1.00, being the value of each loyalty point granted of R1.25 reduced to take into account expected forfeiture (80% × R1.25 = R1.00). Accordingly, management defers recognition of revenue of R100 (100 points x R1).

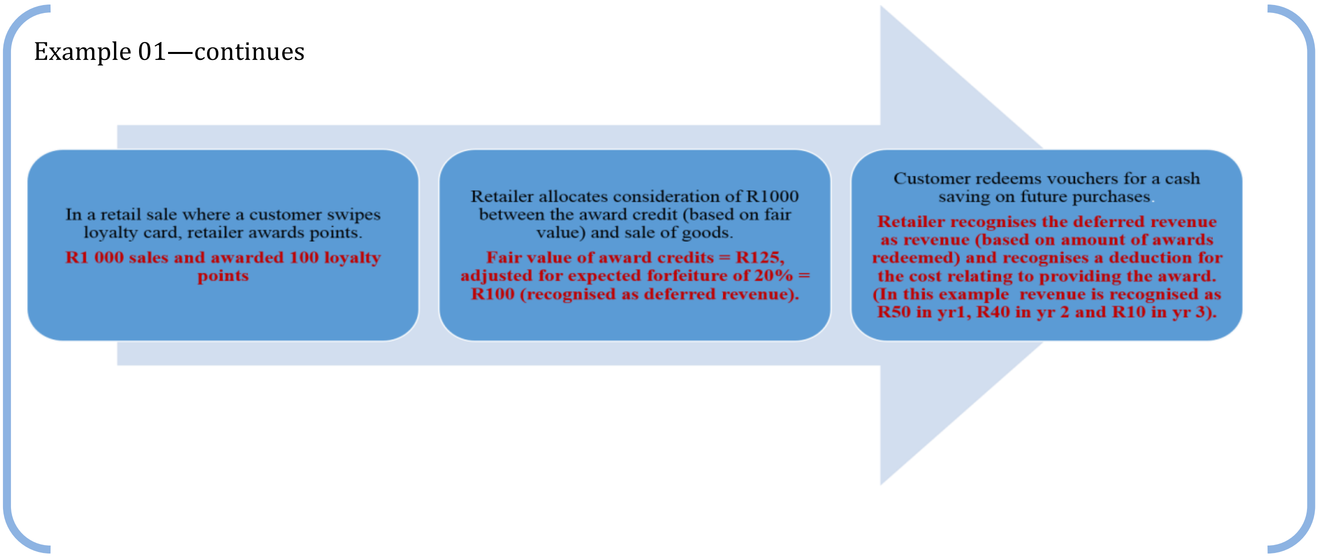
Year 1
At the end of the first year, 40 of the points have been redeemed in exchange for groceries, i.e. half of those expected to be redeemed. The entity recognises revenue of (40 points/80 points) × R100 = R50.

Year 2
In the second year, management revises its expectations. It now expects 90 points to be redeemed altogether.
During the second year, 41 points are redeemed, bringing the total number redeemed to 40 + 41 = 81 points. The cumulative revenue that the entity recognises is (81 points/90 points) × R100 = R90. The entity has recognised revenue of R50 in the first year, so it recognises R40 in the second year.

Year 3
In the third year, a further nine points are redeemed, taking the total number of points redeemed to 81 + 9 = 90. Management continues to expect that only 90 points will ever be redeemed, i.e. that no more points will be redeemed after the third year. So the cumulative revenue to date is (90 points/90 points) × R100 = R100. The entity has already recognised R90 of revenue (R50 in the first year and R40 in the second year). So it recognises the remaining R10 in the third year. All of the revenue initially deferred has now been recognised.

[1] Redemption of PnP award credits may be used, in addition to cash saving on future purchases, to convert to airline points to earn a saving on travel, as well as donating cash to a selected charity of your choice. PnP provides these awards and not any 3rd party

The above example is analyzed and applied with respect to the process of the CLP's from the perspective of the retailer.



Example 1 illustrates the different amounts apportioned to revenue recognized immediately and deferred revenue as used in a CLP. Though, IFRIC 13 is prescriptive in accounting for CLP's, it does not require companies to present all this data within the AFS. In both of the cases used in this study, the companies disclosed the amount of deferred revenue recognized at the end of their reporting period, together_with the expected redemption/forfeiture rate in their AFS.

4.02 Analyzing the cases

4.2.1 PnP

PnP operates a 'smartshopper' CLP where customers are rewarded with 'smartshopper' points (award credits) which are effectively used as cash back benefit against future purchases (as represented in Example 1). Therefore, for every R1 spent at PnP, the customer earns 1 'smartshopper' point and when a customer accumulates 1 000 'smartshopper' points, they will be entitled to a R10 cash back benefit on future purchases (Pick n Pay Holdings Limited, 2013).

The authors have extracted the following information from the PnP AFS:

- The total deferred revenue relating to the CLP at the end of the 2013 financial year amounted to R139.8 million (2012: R142 million). This amount represents the value of 'smartshopper' points granted but not yet redeemed.
- These amounts are adjusted for an expected forfeiture rate of 25% in 2013 and 22% in 2012.

The PnP AFS do not provide a reconciliation of the 2012 to the 2013 balance of deferred revenue, hence it is not possible to determine how many award credits were redeemed or granted during the 2013 year. However, the 'smartshopper' CLP was only introduced by PnP during their 2012 financial year, therefore the authors have concluded that the 2012 deferred revenue balance (adjusted for the expected forfeiture rate) is the minimum amount of award credits granted by PnP during 2012 (Pick n Pay Holdings Limited, 2012). The amount of R142 million (2012), adjusted for the forfeiture rate of 22%, therefore amounts to a minimum amount of R182 million award credits granted by PnP during 2012.

4.2.1 Clicks

The group operates a loyalty scheme through the 'Clicks ClubCard'. The card allows customers to accumulate points which provide them with vouchers that may be used as cash discounts on future purchases (as represented in Example 1) (Clicks Group Limited, 2012a; 2012b).

The authors have extracted the following information from the Clicks AFS and the Integrated Report:

- The total deferred revenue relating to the CLP at the end of their 2012 financial year amounted to R74 million (2011: R69 million). This amount represents the value of unredeemed award credits at year-end.
- These amounts are adjusted for an expected forfeiture rate of 15% in 2013 and 22% in 2012.
- Value returned to customers in the form of 'Clicks Clubcard' vouchers amounted to R231 million in 2012 (2011: R223 million).

4.03 Taxation implications

The authority for the imposition of tax in South Africa is consistent with that of international tax law of most modern tax systems (De Koker and Williams, 2013). This tax system assumes a tax liability for any person who enjoys the legal, political and economic benefits of association with South Africa and can therefore be called upon to contribute to the costs of government (De Koker and Williams, 2013). Essentially the South African income tax system rests upon the definition of 'gross income' as contained in section 1 of the Income Tax Act No 58 of 1962 ("the Act") (Clegg and Stretch, 2013). In using gross income as the starting point, a person's taxable income will be determined by means of a reduction process (Clegg and Stretch, 2013). The basis of this process for normal tax purposes is to include an amount into gross income if such an amount has been received by or accrued to a person during the year of assessment (Clegg and Stretch, 2013).

Direct taxation as dealt with in the Income Tax Act no 58 of 1962 (the Act), addresses the tax implications relating to both income and expenditure. The basis premise implemented by this Act is where one taxpayer seeks to claim a deduction for expenditure paid to another, the latter will include the corresponding receipt into income (Pidduck and Odendaal, 2013). This can be illustrated by the following example:

Example 02 – Equitable tax system

Taxpayer A provides goods and services to Taxpayer B for an amount of R10 000. In terms of the legislation, provided that no exceptions apply, Taxpayer B would be allowed to deduct R10 000 in costs in order to arrive at an amount of taxable income. Taxpayer A would, provided that no exceptions apply, include the R10 000 as income in calculating his/her taxable income.

The resulting tax consequences arising from such a transaction allow the *fiscus* to tax one taxpayer on additional gross income, whilst allowing a deduction for expenditure for the other. This equitable distribution allows the South African Revenue Service ("SARS") to see the cumulative effect of the transaction from the perspectives of both taxpayers and would tax each accordingly. Though this principle is evident in the above example, it does not occur in CLP's in South Africa. In its current form the taxpayer providing the CLP award credits is allowed a deduction for the costs of providing these awards, but the taxpayer receiving the CLP award credits does not include this benefit in its gross income. Literature identifies that the discrepancies in this system is not due to inadequate legislative requirements, but from inadequate administrative processes within the manner in which different forms of income streams are identified (Pidduck and Odendaal, 2013). A short discussion on the requirements for gross income and the general deduction formula is included below for purposes of understanding.

In order for an amount to be included in a taxpayer's gross income it must satisfy the definition of gross income as defined in the Act. Gross income is defined in section 1 of the Act as the total amount received by or accrued to the taxpayer whether in cash or otherwise during the year of assessment excluding receipts of a capital nature (Income Tax Act No. 58 of 1962). In determining if the receipt of CLP award credits satisfies this gross income definition, each element should be considered individually. In literature regarding the taxation of CLP's, each of the components of the gross income definition were considered individually in order to determine if the receipt of CLP award credits should be included in a taxpayers gross income and has been summarized below (Pidduck and Odendaal, 2013):

- Total amount in cash or otherwise: The receipt of CLP award credits do meet the requirement to be included in a taxpayer's gross income as the term 'amount' includes receipts or accruals not only in the form of money, but the value of every form of property earned, whether corporeal or incorporeal, which has a money value (De Koker & Williams, 2013, para. 2.13; CIR v Butcher Bros (Pty) Ltd, 1944, p.34; CIR v People's Stores (Walvis Bay) (Pty) Ltd, 1990, p.21; WH Lategan v CIR, 1926, p. 20)
- Received by or accrued to: CLP award credits should be included in a taxpayer's gross income upon earlier of receipt or accrual ("Commissioner for Inland Revenue v Delfos," 1933; De Koker and Williams, 2013).
- Not of a capital nature: The receipt of CLP award credits is certainly not anything that produces further income and can therefore not be classified as capital in nature in terms of the gross income definition. ("Commissioner for Inland Revenue v Visser," 1936).

In light of the above, the receipt of CLP award credits does in fact satisfy the definition of gross income and should thus be included within a taxpayer's gross income.

The general deductions formula is contained in section 11(a) and 23(g) of the Act and provides that in the determination of a person's taxable income from carrying on trade, the following requirements should be met in order to be allowed as a deduction expenditure or loss: not of a capital nature, actually incurred in the production of income. In literature regarding the taxation of CLP's, it was determined that the costs associated with provision of the benefit once a customer redeems a CLP award credit, do in fact satisfy the requirements of the general deduction formula as any financial outlay would qualify as an expense, actually incurred for purposes of trade (i.e. provided to customers) which is in the production of income (Pidduck and Odendaal, 2013). Therefore these costs are correctly being deducted by those taxpayers providing the benefits under CLP's.

4.04 Implementing tax on CLP award credits

Though the authors do not dispute the rights of the *fiscus* in South Africa to tax the receipt of CLP award credits as provided in the existing legislation, it is crucial to consider the ability of the SARS to administer and manage this previously untapped source of revenue. One of the most important factors to consider in the current context is the lack of resources available for administering this type of revenue. (Calvert, 2012). Therefore the most effective and efficient option for the use of scarce resources may be to use a current form of administration which may be used to minimize the impact of employing entirely new resources for an onerous administration process.

In addition to the scarcity of resources for a new administration process, another crucial consideration is to maintain the integrity of the CLP's so that the tax attached to the CLP award credits do not discourage businesses or taxpayers from entering into them. Therefore any system for administering the taxation of CLP's would need to be simple to administer using the least possible scarce resources and have as little impact on the actual functioning of the CLP's as possible. In a previous article from the authors on the taxation of CLP's, one possible option for the revenue authority in South Africa was identified for this purpose satisfying these criteria. The option most suitable was to use an adapted version of one of the current types of taxation used in South Africa, namely a withholding tax (WHT).

Withholding taxes are most often used when taxing non-residents. In brief, non-residents are generally subjected to tax from a South African source or deemed to be from a South African source. Otherwise non-residents are taxed on the same basis as residents, subject to certain exceptions (De Koker and Williams, 2013). However, in order to reduce the onerous administration required for each non-resident, the SARS is able to with relative ease administer a withholding tax that is effectively managed by a resident taxpayer and paid to SARS directly. In essence the collection of a WHT by the revenue authority differs to that of other normal taxes because although the person to whom the income is paid or accrues is liable for the tax, the obligation to withhold the tax is imposed on the person who pays the amount (De Koker and Williams, 2013).

However, WHT has most recently been applied to both residents and non-residents in relation to dividend income. If the revenue authority chooses to apply a WHT on the receipt of CLP award credits, it would mean that the entity providing the award credit would withhold a percentage of the award credit and provide the customer with the net award credits remaining. This would allow the provider to pay the WHT to SARS directly and manage this process without impacting significantly on the administration required to be performed by SARS. The customer would then then be exempted from including the CLP award credits in their taxable incomes as the WHT has already been levied and paid in relation to this income. The advantages of using a WHT includes, amongst others, the following (Pidduck and Odendaal, 2013):

- All persons receiving CLP award credits would be subjected to the WHT as opposed to registered resident taxpayers. This would significantly increase the amount of WHT to be generated from CLP award credits, as whilst only 13.7 million taxpayers were registered for the 2012/2013 year there is a population of 51.7 million people in South Africa per the 2011 census (SARS, 2012; Solidarity, 2013; Statistics South Africa, 2011).
- The resources required to implement a WHT is significantly reduced as this form of taxation is already used for other revenue streams. The resources required would be significantly lowered when compared to that required when introducing an entire new system, developing legislation and internal systems. In addition to minimal extra administration by the revenue authority, the administrative burden of declaring the amount of CLP award credits granted will only be imposed on approximately 80 businesses having a CLP, rather than an excess of 15 million customers belonging to a CLP's (Kearney, 2013).
- Taxpayers receiving the CLP award credits would also be in a more advantageous position as it would effectively eliminate onerous burdens on tax administration when completing their individual tax returns.
- Arguably the largest benefit derived from implementing a WHT on CLP award credits would be that of perception management. Should a different method of taxation be implemented, the often price sensitive customers may result in making the CLP less attractive and ultimately undermine the essence of a CLP. If a WHT is implemented the customer would receive CLP award credits after the tax has been deducted and would therefore not be required to pay additional tax when submitting their tax returns.

The most notable disadvantage to a WHT is the reduced rate at which WHT is normally levied, as WHT's are currently levied between 5% and 15% which is significantly lower than the direct taxes levied using a sliding scale between 18% - 40% (Haupt, 2013; Pidduck and Odendaal, 2013).

4.05 Managerial implications

For the entities operating a CLP, applying a WHT would mean a more onerous payment and reporting requirement to SARS and may certainly mean an increase in the number of staff required to be invested in managing the CLP. Further, the cash flow implications may not be aligned as payments of the WHT to SARS will almost certainly not occur at the same time as the redemption of the CLP award credits by customers (when the deduction for providing the benefit would be allowed). Similarly, the business would still be liable to pay the WHT to SARS irrespective whether a customer redeems the CLP award credits, adding further cash flow implications to the business.

Notwithstanding the above, the administrative and cash flow burdens would only occur for those businesses choosing to operate a CLP and thus the proportion of businesses affected would be minimal in comparison to the number of businesses operating in South Africa. This would allow the management of each business to determine if the benefits derived from the use of a CLP outweigh the administrative burdens. Similarly, this administration is significantly lower than that experienced by each individual belonging to a CLP had the administration burden been imposed upon them rather than the business.

4.06 Case studies and findings

In implementing a WHT on CLP's for the cases selected, the authors have quantified the additional revenue that may be generated by the revenue authority in South Africa as follows:

Case Study	Value of award credits granted in 2012[2]	WHT at 10%
PnP	R182 million	R18.2 million
Clicks	R231 million	R23.1 million
Total		R43.1 million

In light of the amounts of WHT calculated above, it is evident that a significant amount of revenue is being lost by the *fiscus* as a result of not taxing the receipt of CLP award credits granted to customers in the retail industry in South Africa. The amount of WHT calculated in respect of PnP and Clicks total R43.1 million, and relate to just one type of CLP for two organizations available for selection within this study. In addition to this, whilst the Clicks CLP is well established, 2012 is the first year of implementation for the PnP CLP and significant growth is expected for this program. This indicates that the amount of R. 43.1 million in lost revenues for the government (calculated based on 2012 figures), is significantly lower than the proportion of revenue that will be lost once this CLP is well established. To indicate the gravity of this growth expectation, PnP 'smartshopper' holders have grown from 5 million users in 2012 to 6.3 million users in 2013 (Pick n Pay Holdings Limited, 2012; 2013). Similarly, growth of CLP's throughout the retail industry will yield additional WHT revenue streams for the government as large growth and improvement of CLP's continues to be employed by businesses in the retail industry. Therefore, WHT revenues for the *fiscus* in future years could still are significantly larger than that calculated in this study. It is the view of the authors that a WHT is, in its current form, the best mechanism to levy a tax on CLP's if the rate of this WHT is levied at such a level that it does not become unattractive to customers and businesses.

5.0 Conclusion and policy implications

The administration and identification of taxable customer loyalty rewards is an immense task for the government departments in any economy. Whilst it has been identified that businesses operating CLP's in the retail sector are allowed to deduct the costs incurred for providing the benefits under such programmes, the award credits granted to customers are not being recognized as revenue in their tax returns. However, amending administration to provide for this tax leakage will require significant resources that the South African government may not be able to commit to addressing this problem. The authors have thus suggested that with the adaptation of a current successful form of tax collection and administration in the form of a withholding tax, this burden is significantly reduced whilst allowing the *fiscus* a significant financial benefit. Similarly, the use of a modified existing form of taxation on CLP's allows the SARS to increase the tax base in South Africa without incurring significant costs of introducing an entirely new form of taxation. This policy implication of an adapted form of taxation administration on CLP's will ensure much needed benefit for the *fiscus* whilst still allowing businesses to maintain the integrity and benefits derived from the use of CLP's. The impact on the *fiscus* for just one type of CLP used within two case studies within the retail industry has led the authors to the conclusion that the loss to the *fiscus* in not taxing the receipt of CLP award credits is significant and delays in addressing this tax leakage will impact on the government's fiscal policy as emphasized by the Minister of Finance on various occasions. The authors thus urge the SARS to close this gap for fiscal leakage in order to prevent inconsistencies in the treatment of CLPs in South Africa.

[2] Professional judgment was used to calculate the financial impact of the CLP's used within the companies and is limited to those disclosed in the AFS. Therefore, it is not possible to quantify the losses to the *fiscus* with complete certainty and accuracy. Despite the limitations identified the authors believe that sufficient information was obtained to prove that the loss to the *fiscus* in South Africa is significant in relation to the taxation of CLP award credits in the retail sector.

Several policy implications are obtained from this study: first, the revenue authority needs to adopt to the changing economic environment in respect the CLP's. If the suggestion of a WHT is adopted, the legislation will have to be changed to accommodate this decision and the tax return of companies will need to be updated to incorporate the WHT on CLP's. If the suggestion of WHT is not adopted, the receipt of CLP award credits meets the definition of gross income and the revenue authority needs to ensure that individuals and companies include such benefits in their tax returns. Second, further policy amendments could be made to limit fiscal leakage with respect to taxation of CLP's in all forms and in all industries. Third, further implications could be considered in respect to Value-Added Tax implications resulting from the provision of free/discounted goods or services via CLP's.

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