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Timing of tax deductions for customer loyalty scheme costs

Taxpayers may deduct an allowance for certain obligations to incur future expenditure in terms of section 24C of the Income Tax Act. This provision has been the subject of a number of recent cases, the latest being *C:SARS v Clicks Retailers (Pty) Ltd.* In this case the SCA ruled in favour of SARS in relation to the application of section 24C to obligations in terms of a customer loyalty scheme. This article briefly reviews this case and the reasoning followed by the court.

Section 24C of the Income Tax Act provides an allowance for certain obligations to incur expenditure in future. The Supreme Court of Appeal (SCA) delivered its judgment in the matter between *C:SARS v Clicks Retailers (Pty) Ltd* ('the Clicks case'), which related to the application of s 24C in the context of a customer loyalty scheme, on 3 December 2019. This article briefly reviews that case.

Facts

Clicks operates a retail business. It awarded points to customers who participated in its loyalty programme when they made purchases. Participating customers enter into a ClubCard contract with Clicks. This contract stipulates that purchases translate into loyalty points. Customers must accumulate 100 loyalty points by a specific date (reward cycle) to qualify for a voucher. At the end of a reward cycle, Clicks issues vouchers that can be used as payment, or part payment, for future purchases. The vouchers can only be used in this manner and not redeemed for cash.

Dispute

Clicks claimed an allowance in terms of s 24C for the estimated cost of sales to honour the vouchers issued in terms of the loyalty programme. SARS disallowed the deduction on the basis that the obligation arose in terms of ClubCard contract, which was not the same contract as the one that generated the income (sale of goods to the customer). Clicks argued that the sale of goods to a customer imposed an obligation on it in terms of the loyalty programme, as the tax court found to be the case. The ClubCard contract merely recorded the terms upon which the obligation arose from such purchases.

Judgment

The court identified three contracts, namely the first sale of goods (in respect of which points are earned), the ClubCard contract (which converts points into vouchers) and the second sale (where the voucher is applied). Clicks derived income from the first sale.

The court held the view that the obligations in respect of the vouchers arose from the ClubCard contract rather than from the first sale. The first sale did not result in any obligation without a ClubCard contract. The first sale was merely an event that resulted in an award of points to the customer. The points could ultimately become a voucher in respect of which Clicks had an obligation in terms of the ClubCard contract if sufficient points were accumulated during a specified period. The SCA concluded that Clicks' argument that the ClubCard contract is inextricably linked to the first sale could not succeed in light of the judgment in *C:SARS v Big G Restaurants (Pty) Ltd,* where the court rejected that notion.

Dlodlo JA stated that even if s 24C could be applied to such inextricably linked contracts, the income generated by Clicks from the first sale would be used to finance the acquisition of stock for purposes of future sales. Wallis JA shared this view that the expenditure funded by Clicks was nothing more than conventional stock purchases in the ordinary course of business rather than stock to fulfil obligations that arose in terms of the loyalty scheme. Instead, he was of the view that the vouchers represented an obligation to allow a discount on the second sale.

Lessons for other taxpayers

Wallis JA concluded his judgment by stating:

> "The interpretation of s 24C is straightforward. First, it requires the conclusion of a contract under which revenue is received by the taxpayer. Second, it requires the taxpayer to undertake obligations under that contract to be performed in the following tax year. Third, the performance of those obligations must oblige the taxpayer to incur expenditure in the future. Fourth, the revenue received from the contract must be used to finance the performance of the taxpayer's obligations under the contract."

Taxpayers who apply section 24C would be well-advised to consider the relevant arrangements critically according to these guidelines to ensure that they qualify for the allowance.

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