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Tax Alert

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Can the Consumer Protection Act influence the timing of gross income inclusions?

In a recent Tax Court judgment of *A Company V CSARS* (IT 24510), the Court was faced with the task of deciding when the revenue arising from the sale of gift cards should be included in the gross income of a taxpayer for purposes of the Income Tax Act (ITA). The Court had to decide whether it was at the point of sale of the gift cards, as had been the taxpayer's practice prior to the introduction of the Consumer Protection Act (CPA) or when the gift card was redeemed, or expired.

We set out the facts of the case briefly below.

The taxpayer carried on business as a high street retailer. As part of the facilities offered to its customers, it sold gift cards. These could be redeemed for goods at any of the taxpayer's stores. The taxpayer had historically maintained a separate bank account for the unredeemed gift card receipts. Notwithstanding this, until the 2013 year of assessment, the taxpayer had declared the revenue from the sale of gift cards in its gross income in the year in which it sold the relevant gift cards and claimed an allowance in respect of future expenditure to be incurred in relation to honouring its obligations under the arrangement (a section 24C allowance).

From the 2013 year of assessment, the taxpayer changed the treatment of these amounts in its tax returns, only recognising the proceeds as income once the gift cards had been redeemed or had expired. SARS assessed the taxpayer on the basis that the proceeds formed part of gross income at the time that the gift cards were sold.

The taxpayer disputed the assessment on two grounds. The first ground focused on the fact that the proceeds of the gift cards were held in a separate bank account until redeemed or expired and were not treated as income by the taxpayer until this time. The court rejected this ground of appeal.

The second and more important ground focused on the provisions of the CPA, more specifically the provisions of that act that deal with prepaid certificates, credits and vouchers as well as the provisions that require the supplier of goods and services to hold and account for consumers property. Under these provisions, the consideration paid by the consumer remains the property of the bearer until such time as the certificate, credit or voucher is redeemed or expires. Whilst it was common ground between SARS and the taxpayer that the sale of the gift cards was regulated by the provisions of the CPA, the impact of the CPA on the tax position of the taxpayer was contested. SARS is of the view that the object of the CPA is the protection of consumer rights and that the gross income inclusion for tax purposes is not subject to any other legislation governing receipts or accruals other than as provided for in the ITA. Put simply, the provisions of non-tax legislation cannot override the provisions of the ITA.

Based on the analysis of the CPA legislation, the Court concluded that the taxpayer only became legally entitled to the proceeds when the gift card was redeemed or have expired. As a result, the taxpayer's appeal was upheld.

In summary, proceeds from the sale of gift cards, to the extent that such gift cards are considered property of the holder under the CPA, are not considered to have been "beneficially received" by the taxpayer. They would thus not form part of gross income for income tax purposes until such time as the gift cards are redeemed or have expired.

Some points to note:

- In addition to the provisions considered by the Court, the CPA contains similar provisions relating to prepaid services which could impact a wider range of taxpayers. The impact of the judgment on other industries with significant prepayments for goods or services (such as the airline industry, hospitality industry, etc.) would need to be explored further to determine the applicability thereof;
- Whilst SARS is correct that legislation such as the CPA cannot amend the statutory provisions of the ITA, it may be possible for such legislation to alter the common law principles around beneficial receipt which have a direct bearing on how the provisions of the ITA are interpreted;
- The court found that whilst the CPA established a form of statutory trust in relation to amounts held on behalf of consumers, there was no requirement in law for the amounts to be held in a formal trust or even in a separate bank account. However, where the amounts are held in the same account as the taxpayer's own monies, the taxpayer must ensure that the balance on the account does not drop below the amount held on behalf of consumers. The court did not address the tax consequences that would arise should the balance of funds in a co-mingled account drop below the amount held on behalf of consumers;
- As the taxpayer's appeal was solely in relation to the tax treatment of the receipts from the sale of the gift cards, the Court did not address the availability of the section 24C allowance in the event that the proceeds on the sale of gift cards are taxed on receipt. Nonetheless, should a taxpayer find itself in a position where the receipts are taxable, to the extent possible, eligibility for the section 24C allowance will have to be considered based on a specific set of facts and circumstances (to the extent future expenditure is to be incurred to meet the taxpayer's obligations in terms of the token, voucher or stamp);
- The VAT implications were also not considered in the judgment. Therefore, to the extent required, a review of the VAT implications will have to be considered on all transactions or "classes of transactions". It is noted that the VAT Act does not recognise the purchase of a 'gift card' as a supply;
- Neither the CPA nor the judgment provides clarity on who the beneficial owner of the interest earned on the entrusted funds is, which raises additional tax considerations;
- Possible sanctions for breach of the CPA provisions must be borne in mind by taxpayers who fail to maintain the requisite cash balances and/or assets required to service the unredeemed gift cards; and

— The judgment was issued by a lower court, is not binding precedent and may still be overturned in the likely event that SARS decides to take the judgment on appeal to the High Court or the Supreme Court of Appeal.

If you are concerned about how proceeds from gift cards or prepayments should be reflected in income tax returns that are due prior to any guidance from SARS being released, we recommend obtaining an opinion from an independent tax practitioner which meets the requirements of section 223 of the Tax Administration Act (28 of 2011).
Such an opinion, which confirms the tax treatment you employ, would guard against "substantial understatement" penalties SARS may impose as a result of incorrect tax treatment. In this regard, KPMG has deep technical skills and experience to provide you with quality tax advice that may be relied upon.

If you have any queries, require assistance or need more information, please contact us:

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