Timing of tax on gift cards

Author: Ben Strauss.

The timing of income tax in relation to retailer gift cards was recently an issue in the interesting case in the Cape Town Tax Court, case number IT 24510, reported as *A Company v The Commissioner for the South African Revenue Service* (IT 24510) [ZATC] 1 (17April 2019).

Judge Binns-Ward neatly set the scene in the opening paragraph of the judgment:

The taxpayer carries on business as a high street retailer of clothing, comestibles and general merchandise. As part of the facilities offered to its customers, it sells gift cards. These can be redeemed for goods at any of the taxpayers stores. The question in this appealis whether the revenue from the sale of the taxpayers gift cards during [the tax year] constituted part of its gross income for the purposes of the Income Tax Act [No58 of 1962 (ITA)] as soon as it was received by the taxpayer (as contended by the Commissioner), or would become such only when the card was redeemed, or having not been redeemed, expired (as contended by the taxpayer).

In terms of s1 of the ITA, a taxpayer must include in its gross income all amounts received by or accrued to or in favour of the taxpayer. In the case it was clear that the amounts in question had not accrued to the taxpayer; the question was whether the amounts were received by thetaxpayer.

Initially, until the 2013 tax year, the taxpayer had declared all of the revenue generated by the sale of gift cards as having been received by it and, accordingly, to be included in its gross income in the year in which the cards were issued and paid for.

However, what significantly muddied the waters was the introduction of the Consumer Protection Act, No 68 of 2008 (CPA), which contains provisions that deal specifically with prepaid gift cards and the like. Put simply, the relevant provisions (s63and s65) of the CPA provide asfollows:

- A gift card expires on the earlier of (i) the date on which its full value has been redeemed in exchange for goods or services, and (ii) three years after the date on which it was issued.
- Any consideration paid by a consumer to a supplier for a gift card is the property of the bearer of the gift card to the extent that the supplier has not redeemed it.
- When a supplier has possession of any prepayment, the supplier may not treat the prepayment as being the property of the supplier. In the handling, safeguarding and use of that property, the supplier must exercise the degree of care, diligence and skill that can reasonably be expected of a person responsible for managing any property belonging to another person. The supplier is liable to the owner of the property for any loss resulting from a failure to comply with thoseobligations.
- A person who assumes control of a suppliers property as administrator, executor or liquidator of an estate must diligently investigate the circumstances of the suppliers business to ascertain the existence of any money or other property belonging to the consumer and in the possession of the supplier, and ensure that any such money or property is dealt with for the consumers benefit in accordance with the salient provisions of the CPA.

After the introduction of the CPA, the taxpayer changed the way that it dealt with amounts paid for gift cards. It began to transfer the revenue generated from the sale of gift cards to a separate banking account that was conducted solely to hold the proceeds of its gift card transactions until the cards were redeemed or became expired. It appears that that course of action is relatively common among retailers in other jurisdictions where gift cards are used.

After it started dealing with gift card revenue in that fashion, the taxpayer stopped including the revenue in its gross income on the basis that the amounts were not received within the meaning of that term in the context of the ITA. In this regard, the court stated the following (atparagraph [17]):

The taxpayers argument that the receipts in respect of the sale of unredeemed gift cards did not constitute part of its gross income was advanced on two levels. The first was that, as a matter of principle, and irrespective of the incidence of the CPA, the fact that the monies received by it in respect of the sale of gift cards are held in a separate bank account, and are not applied in the conduct of the taxpayers business, until the cards are redeemed or expire, and that they are discretely accounted for in its financial records as an unredeemed gift card liability, renders it inconsistent with it being income within the ordinary meaning of the word until such time as it is appropriated. This argument is premised on the contention that the facts demonstrate that the money is not received for the taxpayers own benefit, but rather to be held for the benefit of another (ie the bearer of the gift card). The taxpayerobtains the benefit of the money taken in only when it discharges its obligation or the card expires. The second level of the taxpayers argument was premised on what it contends is the legal effect of the characterisation of its receipts in respect of unredeemed gift cards in ss 63 and 65 of the CPA, coupled with its treatment in practice of those receipts consistently with the statute.

The court rejected the first level of the argument. It found that the argument was based on the notion that the moneys were received and, pending the redemption or expiry of the cards, somehow held in trust for the benefit of the cardholders. The court held that the mere segregation of the receipts in respect of unredeemed gift cards in a separate banking account identified for that purpose did not mean that the taxpayer did not hold the money for itself and for its own benefit.

The taxpayer might have seen itself as some sort of trustee but there was no evidence that it had bound itself in a legally effective manner to hold the receipts in a fiduciary capacity. It did not matter where the taxpayer kept it, or how it accounted for it in its books. It could have spent it or saved it as it wished for its own benefit.

The court found, accordingly, that the taxpayer was correct to have included its receipts in respect of unredeemed gift cards in its accounting for its gross income in the period before the commencement of the CPA.

However, the position changed after the introduction of the CPA. According to the court, the question that then arose was whether the taxpayers method of dealing with the gift card receipts in apparent compliance with the requirements of the CPA entailed that it received the proceeds for itself, or for the gift card bearers. The court held that the CPA required it to take and hold the receipts for the card bearers, and to refrain from applying them as if they were its own property, and its method of dealing with the receipts was directed to doing just that. The CPA forbade the taxpayer from receiving the moneys taken in for gift cards for itself until the cards were redeemed. Accordingly, the gift card receipts were received by the taxpayer, not for itself, but to be held for the cardbearer.

The court held, accordingly, that the receipts on account of gift cards were correctly not included in the taxpayers gross income and that the relevant assessments should be set aside.

The counsel for the Commissioner raised an interesting argument, namely, that the CPA was introduced to protect consumers rights, and not to change the incidence of tax. In that regard, the court held asfollows:

[I]f the manner in which the CPA protects consumers entails the deferral of beneficial receipt of revenue by suppliers as a matter of fact, then the knock-on effect on the determination of the suppliers taxable income is only to be expected. Were it otherwise, the necessary implication would be that suppliers fall to be taxed on income they have not yet received, and which has not yet accrued to them. The CPA does not express any such intention. And any such effect would be at odds with the scheme of the [ITA]. A conflict between the two sets of legislation arises only if it is construed in the manner contended for by the Commissioner. It does not arise on the approach contended for by the taxpayers counsel.

The court accordingly dismissed that argument. Essentially, the court found that the Commissioner cannot apply fiscal laws in a vacuum; he must determine the incidence of tax in the real world, and in light of all the relevant facts and circumstances, including common law or legislation that requires taxpayers to act in a certain manner.

download PDF