GST Public Ruling Request – Loyalty Programs

Reason for ruling

There is currently no public ruling in the Public Goods and Services Tax Ruling ("GSTR") series that specifically deals with the GST issues arising out of the operation of loyalty programs, where members of a loyalty program accrue points on a "dollar spent" or consumption basis. As is common in these programs, once a prescribed amount of loyalty program rewards points have been earned by the member, the member will have the opportunity to exchange these rewards points for either goods, services or a gift card.

The current ATO view is limited to a solitary Australian Taxation Office ("ATO") media release titled "No GST on loyalty" issued in March 2000 (Media relase – 2000/14). The ATO's view in this media release is contained in a single general statement that "the accrual and conversion or redemption of points by members into goods or services will not be subject to GST".

Further, whilst there are several GST private binding rulings ("PBRs") that have been issued by the ATO, (which do not represent binding authority to taxpayers that did not specifically receive the PBR themselves), and a degree of case law from the United Kingdom on the topic, there is a significant degree of uncertainty for taxpayers with respect to the GST treatment of these programs.

There are published ATO views in other rulings, specifically in *Goods and Serves Tax Ruling 2003/5: vouchers* in the GSTR series but these other rulings do not necessarily confirm that these views also apply to loyalty programs.

It is also noted that the proposed limit to the range of ATO publications that will be regarded as 'public rulings' (as of 1 July 2010) and the review of those documents that contain the ATO precedential view would seem to be an ideal opportunity for the ATO to bring its views together in a GST Ruling on this particular issue.

Please find out the some topics that we suggest should be included in any proposed GSTR in respect of loyalty programs.

Suggested topics to be considered

1. Technical GST questions as to the character or legal nature of the rewards points

In a Taxation Institute of Australia paper prepared by ATO Senior Tax Counsel, Andrew Orme, which was distributed in September 2009, Andrew Orme observes that the multitude of potential GST analyses in respect of loyalty program arrangements will give rise to different GST consequences.

Andrew Orme states that there are two key questions for promotions that involve rewards points when another good or service is purchased. The first question is how the transaction should be construed:

- Does the transaction comprise of two completely separate supplies (one of the paid item and one the free item);

DRAFT

- Is it a mixed supply of the paid goods/services and rewards points which gives rise to different GST treatments of the two components of the mixed supply; or
- Is it a single composite supply for GST purposes that cannot be dissected?

He goes on to state that if it is determined that the transaction represents completely separate supplies, or a mixed supply, there is a second question to be answered, which is whether GST is determined by reference to the price that the parties purport to allocate to each item (i.e. full price to one item and giveaway to the second), or whether an apportionment between the items on a reasonable basis is required.

Essentially, the central issue to be determined is the legal characterisation of rewards points (i.e. are they rights or are they a mere representation of an entitlement to future supplies or are they something different altogether).

From a commercial point of view, a loyalty program is effectively a discount arrangement under which the attribution of the discount is delayed until a later point in time. In many circumstances the technical basis for GST not arising on the provision of the discount, in the form of goods or services at a later point in time, is not the central focus.

This is due to the fact that GST is ultimately remitted to the ATO as 1/11th of the consideration received by the supplier of both the original goods and services and the goods and services later rewarded, where both these supplies are taxable. This appears to be the correct economic outcome.

However, the growing popularity in the use of loyalty programs by businesses results in growing complexity and innovation in the manner in which the programs are conducted and the rewards that can be redeemed by members.

This in turn results in what would seem to be the emergence of unintended consequences, and importantly a need to clearly establish the technical legal application of the GST law regarding loyalty programs.

2. Provision of GST-free or input taxed goods or services on redemption of rewards points by members

The ATO view in the media release that rewards points earned as part of loyalty programs do not have a separate identity or value in their own right may give rise to unintended GST outcomes where GST-free or input taxed goods or services are provided to members upon the redemption of rewards points.

For example, where a member acquires a fully taxable good, the member will earn rewards points for this purchase. The retailer will remit 1/11th of the entire consideration received for the taxable goods to the ATO.

The member may opt to redeem their rewards points for a GST-free goods. In this instance, taking into account the current ATO view that the rewards points do not have an independent identity and are not a separate supply to the goods or services for which the points are earned, the retailer will remit GST on 1/11th of the entire original transaction, despite the fact

DRAFT

that it has effectively supplied two goods for the original consideration provided by the member (i.e. a proportion of the consideration provided by the member relates to the GST-free goods).

If the same economic transaction was made as one bundled transaction (i.e. the taxable and GST-free good sold together to the customer for the same consideration), GST would not be remitted by the retailer on the consideration that relates to the GST-free goods.

This gives rise to an unintended GST consequence.

3. Provision of a Division 100 voucher by a retailer to a member of its own loyalty program in exchange for rewards points

Instead of providing the member with direct goods or services on the redemption of rewards points, the retailer may issue the member with a Division 100 voucher.

The Commissioner has previously taken the view in PBR (Authorisation Number: 9790) that a Division 100 voucher issued by an entity as a reward to a member of its own a loyalty program on redemption of points is subject to GST when redeemed for goods.

Presumably the rationale for such a decision (the rationale is not entirely clear from the relevant PBR) is that the Division 100 voucher was supplied for consideration as it was effectively paid for when the points used to redeem the gift card were earned. That is, the loyalty program member acquired a bundle of two things during the point earning transaction: (1) goods; and (2) an entitlement to additional goods or services at a later point in time.

The result of this is GST will effectively be remitted twice by the retailer (i.e. the first time on the consideration received on the original supply and GST will be remitted a second time when the gift card is redeemed for goods or services).

However, the uncertainty in the view in respect of these arrangements is evidenced in the ATO issuing a PBR (Authorisation Number: 1011318081447) with a conflicting view. In these particular circumstances, the ATO ruled that the rewards points issued as part of this loyalty program, in conjunction with the purchase of goods did not constitute a supply for consideration. As any voucher provided to the member upon the member's redemption of these points would be for nil consideration, the voucher provided by the retailer would not constitute a Division 100 voucher.

This confusion in conflicting views provides even more of an incentive for the ATO to issue a GST ruling in this regard.

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4. Acquisition of Division 100 vouchers by retailer from other entities for the retailer to provide to member in exchange for rewards points

Division 100 was inserted to deal with the difficulties that arise where a voucher is used to acquire goods or services that are GST-free or input taxed. The logic in inserting a GST delaying mechanism is obvious.

However, the effect of treating the supply of a voucher as not being a taxable supply is that the ability for an entity acquiring a voucher in the course of their enterprise will generally not be entitled to an input tax credit (assuming the acquiring entity will not redeem the voucher for supplies to it).

The net impact in this scenario is that a GST liability arises without entitlement to an input tax credit under a Business to Business ("B2B") transaction. The inequity of this outcome is heightened in the context of B2B transaction scenarios where the business acquiring the gift cards on-supplies the gift cards to employees or loyalty program members for no additional consideration.

5. Discrepancies between acquisitions made by non-financial institution entities and financial institutions and insurance companies

(a) Acquisitions of goods/services by financial institution to provide to loyalty program member in exchange for rewards points

An entitlement to an input tax credit on an acquisition (that is itself a taxable supply) arises to the extent that the thing is acquired in carrying on an enterprise. However, that entitlement is limited to the extent that the acquisition relates to making supplies that would be input taxed.

There would appear little doubt that the operation of a loyalty program, whether alone or as part of a wider activity, is an enterprise and the acquisitions made in such operations are made in carrying on an enterprise. The question then is whether the acquisition relates to making supplies that would be input taxed.

A loyalty program operator who makes only taxable or GST-free supplies is entitled to a full input tax credit on acquisitions made to supply rewards to loyalty program members. However, the position in relation to loyalty program operators that make input taxed supplies may be different. Take for instance a financial institution which operates a loyalty program in association with its credit card business. Under the program, a credit card customer earns rewards points for each dollar repaid on outstanding balances. The customer may redeem points with the financial institutions for goods and services acquired by the financial institution. To what extent is the financial institution entitled to claim an input tax credit in respect of the taxable goods and services acquired by it to supply to customers who redeem points?

As noted above, the ATO has expressed the view that the delivery of the goods or services paid for by points is not a separate taxable supply for GST purposes. However, there is still a supply of the goods or services made in carrying on the enterprise. Can it then be argued that the acquisition of the goods or services relates to the subsequent supply of those goods

DRAFT

or services, which is not input taxed, and therefore there is nothing limiting the financial institution's entitlement to full input tax credits? This view is somewhat supported in the Federal Court case, *American Express International Inc v Commissioner of Taxation [2009] FCA 683*.

Alternatively, what if there is a taxable supply of the points or of the goods or services on earning of the points as suggested above? In this regard, can it be argued that the nexus between rewards and a supply for a financial institution is more closely associated with the financial institution earning interchange and merchant fees rather than the provision of credit. This should then allow full input tax credits to be claimed on the acquisition, but may also require a GST liability to be accounted for on the supply of an interest in a credit arrangement or a right to credit.

(b) Acquisitions made from other entities for an insurance company to provide to insured member

The issue outlined above at section 4 in respect of general B2B voucher transactions gives rise to a neutrality issue when compared against the GST outcome that arises in a B2B transaction where an insurer is the acquirer of the voucher.

An insurer is entitled to a decreasing GST adjustment equal to 1/11th of the market value of a supply that it makes in settlement of a claim to a customer that is not registered for GST.

This decreasing adjustment arises where there is no entitlement to an input tax credit for the acquisition of the thing supplied.

Therefore, where an insurance company acquires a Division 100 voucher to supply to unregistered customers in settlement of a claim, the insurance company will generally be entitled to a decreasing GST adjustment equal to 1/11th of the market value of the voucher provided.

Giving rise to an unintended consequence, this scenario provides insurers with an obvious commercial advantage to those entities that do not supply insurance yet acquire gift cards.

6. Tripartite loyalty program arrangements

Many loyalty program operators provide gift cards and/or goods and services that the operator legally acquires from other entities (participating partners).

The participation partner will usually pay a participation fee to the loyalty program operator.

In respect of goods/services that are provided by the operator in exchange for rewards points, the member may be able to receive the participating partner's goods/services from the loyalty program operator in exchange for rewards points. Where the member does not have the requisite points to redeem for the entire goods/services, the member may be able to make up any shortfall in the price of the goods by making a monetary payment.

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Where these goods/services are paid for partly by rewards points, and partly paid through further monetary consideration provided by the member to the participating retailer, the question arises as to who the participating retailer legally makes the supply of the goods/services to (i.e. Is the entire supply of the goods/services made to the retailer or is the supply of the goods/services made to both retailer and the member?).

The ATO has previously taken the view that the supply of the reward by the participating retailer is actually made to the loyalty program operator and merely provided to the member. The ATO views the loyalty program member as making the acquisition of services pursuant to the contractual arrangement between the participating retailer and loyalty program operator (*Private Ruling 56637*).

It is noted that this ATO view contradicts the view adopted by the Commissioner of Taxation in the full Federal Court case *Secretary to the Department of Transport (Victoria) v Commissioner of Taxation* .

This clearly causes confusion amongst taxpayers as to the GST treatment of these types of transactions.

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