THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable
Case No: 58/2019

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

CLICKS RETAILERS (PTY) LTD **RESPONDENT**

Neutral citation: *The Commissioner for the South African Revenue Service v Clicks Retailers (Pty) Ltd* (58/2019) [2019] ZASCA 187 (3 December 2019)

Coram: Wallis, Swain, Mbha and Dlodlo JJA and Hughes AJA

Heard: 22 November 2019

Delivered: 3 December 2019

Summary: Income Tax Act 58 of 1962 – s 24C – claim for allowance in respect of cost of complying with terms of loyalty card programme – customer applying for issue of card – award of points on value of purchases – vouchers issued based on number of points accumulated –vouchers presentable as part payment for future purchases of goods – whether amount received from earlier sales used to finance future expenditure on same contract

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ORDER

On appeal from: The Tax Court, Cape Town (Nuku J):

1 The appeal is upheld with costs including the costs of two counsel.

2 The order of the Tax Court is set aside and replaced with the following:

'The appeal is dismissed.'

JUDGMENT

Dlodlo JA (Wallis, Swain and Mbah JJA and Hughes AJA concurring):

[1] Clicks Retailers (Pty) Ltd, the respondent, owns and operates the well-known Clicks retail business at stores nationwide. Some years ago it instituted a Loyalty Programme in terms of which it awards points to members on presentation of a Clicks ClubCard when making purchases. The accounting and tax treatment of purchases made using a ClubCard and the benefits accruing to members as a result attracted the attention of the appellant, the Commissioner: South African Revenue Services (the Commissioner or SARS as may be appropriate). After conducting an audit the Commissioner disallowed Clicks' claim to an allowance in terms of s 24C(2) of the Income Tax Act 58 of 1962 (the Act). An appeal to the Tax Court, Cape Town (Nuku J) succeeded. The appeal by the Commissioner is with his leave.

[2] The loyalty programme does not apply automatically to all Clicks customers. A customer has to apply either in writing, online or telephonically in order to become a member of the loyalty programme. Upon acceptance of the customer's application, Clicks issues a ClubCard to a customer. A temporary card is issued to a customer who applies in-store. The terms and conditions of the ClubCard contract regulate the relationship

between Clicks and the customer under the loyalty programme. It does not cost anything to join the loyalty programme, nor do any financial benefits accrue to either party as a result. Customers in possession of a ClubCard are under no obligation to shop at Clicks. In order to become entitled to points under the loyalty programme a customer must purchase goods and present his or her ClubCard at the checkout point in respect of that transaction. Every R5.00 spent earns one loyalty point. In order to qualify for vouchers customers must accumulate at least 100 club card points by a qualification date. There are four qualification periods during which the minimum points have to be earned (6 October-5 January; 6 January – 5 April; 6 April – 5 July; 6 July – 5 October). These periods are referred to as reward cycles.

[3] At the end of each reward cycle, Clicks issues vouchers to all ClubCard members who have earned 100 or more points during the cycle. Every 100 points earned by a customer will entitle that customer to a voucher to the value of R10.00 that can be used in payment or part payment for his or her future purchase. Vouchers may be redeemed by the customer when he or she makes a subsequent purchase and presents his or her club card and voucher at the checkout point. The voucher cannot be redeemed for cash. In practice the vouchers will in almost all instances be used in part payment of a basket of goods, so that the customer acquires those goods at a discounted price.

[4] During the 2009 financial year, Clicks claimed an allowance of R44 275 965 to be deducted from its gross income based on s 24C of the Income Tax Act. The allowance was calculated on the basis of the cost of sales to Clicks, in honouring vouchers that Clicks expected members to redeem in the following tax year. The Commissioner disallowed the claim to the allowance and Clicks objected to the disallowance. On 29 April 2015 it lodged an appeal against the disallowance of its objection against the assessment for the 2009 tax year.

[5] The Tax Court upheld the appeal and directed the Commissioner to partially allow Clicks' claim in terms of s 24C and revise the allowance, for the following reasons;

(a) It was artificial and factually incorrect, to regard the expenditure Clicks would incur when a customer redeemed a voucher, as arising under a 'different contract' to the first purchase and sale contract concluded with the same customer and pursuant to which the points concerned, were generated.

(b)The first purchase and sale agreement incorporated the terms of the ClubCard contract, but despite this the first purchase and sale contract remained the contract that triggered both the earning of income by Clicks as well as an obligation by Clicks to incur future expenditure.

(c) The obligation to incur future expenditure was therefore incurred under the same contract from which the income was earned and the expenditure would be incurred in the performance of that contract. Consequently the claim of Clicks in terms of s 24C, met the requirements of this section.

[6] Section 24C was amended in 2016. This was subsequent to the relevant year of assessment. The wording of the Act as it was in 2009 needs to be applied. The section then read:

'(1) For the purposes of this section, "future expenditure" in relation to any year of assessment means an amount of expenditure which the Commissioner is satisfied *will be incurred* after the end of such year -

(a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or

(b) in respect of the acquisition of any asset in respect of which any deduction will be admissible under the provisions of this Act.

(2) If the income of any taxpayer in any year of assessment includes or consists of *an amount received by or accrued to him in terms of any contract* and the Commissioner is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer *in the performance of his obligations under such contract*, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such expenditure as in his opinion relates to the said amount.

(3) The amount of any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment.' [My emphasis].

[7] In *CSARS v Big G Restaurants (Pty) Ltd* [2018] ZASCA 179, 2019 (3) SA 90 (SCA) this court held that in order to qualify for the allowance the income received and the future expense to be incurred, must arise from the same contract. It said that s 24C had two basic requirements: first, there must be income received or accrued in terms of a contract and second, the Commissioner must be satisfied that such amount, i.e. the income received from the contract, will be used wholly or partially to finance future expenditure that a taxpayer will incur in performing its obligations under that same contract. The section therefore envisages income, future expenditure and a single contract that links the two. This court expressly rejected the notion that the section applies where the different contracts are 'inextricably linked.' The legislature did not use the term 'scheme' or 'transaction'. The operative concept was 'contract.'

[8] An application for leave to appeal to the Constitutional Court against the judgment in *Big G* was argued shortly before the appeal in this case. Counsel were agreed that the issues before the Constitutional Court were not the same as the issues in the present case. The relevant principles are dealt with and explained in the concurring judgment by my brother Wallis JA, which I have read and with which I agree. I continue to deal with the present case in accordance with those principles.

[9] The Commissioner submitted that the deduction was correctly disallowed, for the following reasons;

(a) The contract of purchase and sale, whereby a customer purchased merchandise at a Clicks store, in terms of which income was received, was separate from the ClubCard contract;

(b) The ClubCard contract itself did not give rise to any income in the hands of Clicks, because it was issued free of charge and there were no hidden charges to members;

(c) The obligation of Clicks to award the member points, based on qualifying sales and to issue vouchers, when the specified number of points had been earned, arose under the ClubCard contract;

(d) Clicks was likely to incur future expenditure, when a member redeemed a voucher and Clicks supplied the member with goods equal to the value of the voucher, at no cost to the member. This obligation would arise under the ClubCard contract, which was a different contract from the contract of purchase and sale, under which the income was received.

[10] On this basis the Commissioner contended that at least three different contracts were discernible;
(a) The ClubCard contract, from which no income was derived, as it was concluded free of charge and imposed the obligation on Clicks to issue and honour vouchers and thereby incur future expenditure;
(b) The first contract of sale, which earned income for Clicks, but from which no obligation to honour vouchers and thereby incur future expenditure was imposed upon Clicks; and
(c) The second contract of sale, which earned income for Clicks and against which the customer was entitled to redeem his or her voucher.
The Commissioner therefore submitted that Clicks had not succeeded in discharging the onus resting upon it, to satisfy the court, that the first contract of sale, from which the income was derived, was the same contract that imposed the obligation on Clicks to incur future expense by redeeming a customer's vouchers.

[11] Clicks, however, submitted that the only issue for determination was whether or not the qualifying purchase i.e. the first contract of sale, was also obligation-imposing, as found by the Tax Court. Clicks submitted that it plainly was and moreover that there was a 'direct and immediate connection' between each qualifying contract of sale, on the one hand, and the obligation on Clicks to issue rewards to the customer pursuant to that contract of sale, on the other. The Tax Court found for Clicks on the basis that 'the income is earned on the same contract that gives rise to the obligation to incur future expenditure.' The 'same contract' here being a qualifying purchase – referred to in the judgment as the 'first purchase and sale contract.'

[12] According to Clicks the Tax Court correctly found that its obligation to incur future expenditure, did not arise from the ClubCard contract, itself. This was because, as the Tax Court found, the ClubCard contract did not itself create or impose on Clicks any exigible obligation to grant any form of rewards to a customer. On the contrary, in terms of the express provisions of the ClubCard contract itself, that obligation only arose when a qualifying contract of sale was made.

[13] Clicks argued that the ClubCard agreement did not give rise to any exigible obligations, or at least none that were relevant for the purposes of the section. That agreement, as the Tax Court found, merely 'records the terms upon which Clicks is to reward the ClubCard holders in respect of their future purchases' and those terms made it clear that the customer had no right to rewards, and Clicks was under no duty to grant them, unless a qualifying purchase was concluded. In addition, the conclusion of a qualifying purchase not only brought into existence an exigible obligation on the part of Clicks to issue rewards, but also determined the content of that obligation, since the rewards to be granted were determined by the value of the qualifying purchase.

[14] Clicks summarised its submissions as follows;

(a) The ClubCard agreement did not itself give rise to any exigible obligation on Clicks to issue rewards.

(b) No such obligation was 'created' by the ClubCard agreement, and no such obligation existed unless and until a qualifying purchase was concluded.

(c) Each qualifying purchase not only brought into existence, but also determined the content of, an exigible obligation on Clicks, to issue rewards.

(d) Accordingly, on each occasion that Clicks issued rewards, there was a 'direct and immediate connection' between Clicks' obligation to do so and the qualifying purchase concerned. Put differently, each qualifying purchase was both 'income-earning and obligation-imposing' as found by the Court a quo.

(e) It followed that the 'same contract' requirement of the section was met.

[15] In my view, the ClubCard contract between the customer and Clicks, establishes the right of the customer to receive points and thereafter vouchers as well as the obligation on Clicks to award points and thereafter vouchers to the customer, redeemable against subsequent purchases. This is how Clicks itself described the position on 29 July 2012, when it replied to SARS' query sheet. It said that to earn points that could be converted into a Rewards voucher the customer had to make purchases and present their ClubCard at the checkout. Clicks explained that under these purchases income accrued to it as the taxpayer. Contrary to its present submissions it then said that this revenue was 'a direct result of the contract entered into when the ClubCard member joins the loyalty programme'. In line with that it continued:

'The specific performance required by Clicks as a result of the contract entered into with the ClubCard member is defined in the terms and conditions of the loyalty programme. Based on the terms and conditions the taxpayer is obligated to provide the member with a rewards voucher to the extent that it has earned points that are redeemable into a voucher as determined in accordance with the rules. The terms and conditions indicate that the rewards voucher can be used to purchase goods in a Clicks store to the value of the rewards voucher. The taxpayer therefore has an obligation to deliver goods to the member to the value of the rewards voucher at no cost to the member. In order to acquire such goods the taxpayer incurs expenditure, which at the time of earning the income was still future expenditure.'

[16] The taxpayer's grounds shifted somewhat when it came to its objection to the assessment. It continued to say that the expenditure incurred by it was incurred 'in performing its obligations under the Loyalty Programme', but started to equivocate in regard to the relationship between this and the contracts of purchase and sale that generated the rewards under the Loyalty Programme. It said that under the Loyalty Programme members were rewarded with points, but:

'There is no separate contract of purchase and sale relating to the goods purchased – the customer's presentation of the ClubCard when paying at the till-point being inextricably interwoven with and an integral part of each purchase and sale of goods transaction entered into by the ClubCard customer.'

[17] The difficulty with this is that, as pointed out above, this court in *Big G* expressly rejected the notion that the section applies where there are different contracts but they

are 'inextricably linked.' Consequently, the fact that the ClubCard contract may be inextricably linked to the first contracts of sale concluded between a customer and Clicks for the purchase of merchandise, and that the loyalty programme could not function without these sales, matters not. In any event, even if the court were minded to adopt Clicks' approach and hold that the ClubCard contract, together with the first sale of merchandise, gave rise to the income, this would not bring the case within s 24C. The reason is that this income would be used to finance the acquisition of stock for future sales, so that the expenditure would be incurred in performing Clicks obligations under the ClubCard contract and the second sale agreement. Even on a linked basis the contract is not the same contract.

[18] The contract that creates the right to income by Clicks is the first contract of sale. However, the contract that obliges Clicks to honour the vouchers and thereby incur expenditure, when a customer concludes the second contract of sale with Clicks, is neither that contract, nor the second contract of sale, but the ClubCard contract. Consequently, the expenditure incurred by Clicks in honouring the vouchers does not arise in terms of the same contract i.e. the first contracts of sale, but in terms of the separate and distinct ClubCard contract.

[19] The distinction that Clicks seeks to draw between the ClubCard contract concluded between the customer and Clicks, in terms of the loyalty program on the one hand, and contracts of sale concluded for the purchase of merchandise, on the other, is artificial. Clicks seeks to minimize the obligations imposed upon Clicks in terms of the ClubCard contract, to the extent that no exigible obligations are imposed upon Clicks at all, in terms of this contract. The basis for this assertion is that each qualifying purchase not only brings into existence, but also determines the content of an exigible obligation on Clicks, to issue vouchers. However, as Clicks itself said in the passage quoted in para 15, the obligation to award points and thereafter vouchers, to a customer in respect of a qualifying contract of sale, arises from the ClubCard contract and not the contract of sale concluded with the customer. To borrow the terminology of Clicks, when a qualifying contract of sale is concluded, the obligation on Clicks either to issue vouchers or to honour them, as the

case may be, in terms of the ClubCard contract, becomes exigible. In the absence of the ClubCard contract, a customer acquires no right to acquire points and thereafter vouchers and Clicks incurs no obligation, to do so.

[20] The argument of Clicks has as its object the reduction of the contractual relationship between a customer and Clicks, to a single qualifying contract of sale, which is 'income-earning' for Clicks and 'obligation-imposing,' because Clicks is obliged to award points to the customer. This argument however ignores the reality of the arrangement, in which three contracts are operative, namely the first and second contracts of sale, as well as the ClubCard contract. All of these contracts are required in order for the customer to acquire vouchers and for Clicks to receive income and be obliged to award vouchers and supply merchandise to the customer in return, as submitted by the Commissioner. As a result, the income received and the future expense sought to be deducted, did not arise from the same contract and the Commissioner correctly refused to grant a s 24C allowance.

[21] In the circumstances, the following order is made:

1 The appeal is upheld with costs including the costs of two counsel.

2 The order of the Tax Court is set aside and replaced with the following:

'The appeal is dismissed.'

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DV DLODLO
JUDGE OF APPEAL

Wallis JA (Swain, Mbha and Dlodlo JJA and Hughes AJA concurring)

[22] I have read and concur in the judgment of my brother Dlodlo JA (the main judgment). I write in order to deal with the decision in *Big G* and our reasons for taking the view that the outcome of this case will not be affected by the outcome of the application for leave to appeal that was recently argued in the Constitutional Court in that matter.

[23] The taxpayer in *Big G* had entered into several franchise agreements entitling it to operate steakhouses and pizza and pasta restaurants under two well-known brand names in accordance with the *modus operandi* stipulated in the franchise agreements. Its source of revenue from operating the restaurants came from contracts to supply food to restaurant patrons. Under the franchise agreements it was obliged from time to time to upgrade and refurbish its restaurants in accordance with the requirements of the franchisor. This required it to incur expenditure in the future. The first issue was whether in accordance with the requirements of s 24C the income it received accrued in terms of the franchise agreement. If it did, the second issue was whether the expenditure to be incurred in refurbishing the restaurants was incurred in the performance of the taxpayer's obligations 'under such contract'.

[24] There was no dispute in *Big G* that in terms of s 24C the future expenditure in relation to which the allowance was sought had to be incurred in the performance of the same contract as that under which the taxpayer had earned the income. The section commences with reference to an amount being received by or accruing to the taxpayer 'in terms of a contract'. It then provides that this amount will be utilised in whole or in part to finance future expenditure. The expenditure in question is that which the taxpayer will in future incur in the performance of its obligations 'under such contract'.

[25] There is a sound reason for this limitation. Most businesses recognise that they will be required in the ordinary course of their operations to incur future expenditure. An obvious example would be the need to make provision for the replacement of machinery and equipment in order to keep their operations up to date. In the case of businesses, such as the restaurants operated by *Big G*, sensible management would in any event,

dictate that the external appearance of the restaurant and its interior décor be subject to refurbishment on a regular basis. This would occur irrespective of whether the business was being operated under a franchise agreement. The finance for such activities would have to be found from the ordinary stream of income of the business, or from borrowings. To permit an allowance for such future expenditure would result in future expenses being taken into account before they were incurred and afford taxpayers a means to manipulate the timing of tax payments. That was not the purpose of s 24C.

[26] The reason s 24C was introduced was not to afford a means whereby the taxpayer could take account of expenses foreseen but not yet incurred, but to alleviate the tax burden that would otherwise rest on builders and other taxpayers engaged in manufacturing businesses, where it is the practice to obtain a deposit or other payment in advance of work being undertaken. This is neither here nor there if the deposit is received and the work done in the same tax year. The amounts received will be declared as income and the expenses incurred in performing the contract deducted as expenses incurred in the production of income. A problem arises where the deposit is paid in one year and the expenses in performing the contract are incurred in the following year. Absent s 24C the contractor would be obliged to declare and pay tax on the whole of the amount received in the first year and be left to set off against other income the expenses incurred in fulfilling the contract in the second year. In effect money paid to finance the performance of the contract would need to be diverted to the payment of tax, leaving the contractor to finance the performance of the contract from other resources. Permitting the taxpayer to deduct an allowance in respect of the cost of financing the performance of the contract in the second year restores the balance between income and expenditure.

[27] The issue in *Big G* was not whether, in order to claim an allowance, the expenditure has to be incurred in performing the same contract as that in terms of which the income was earned. It was whether the income was earned under the franchise contract, either alone or in conjunction with the sale of meals to restaurant patrons, so that it could be said that the expenditure *Big G* would incur under the franchise agreement in respect of refurbishment would be incurred under the same contract as that under which the income

was earned. This court said that it was not the same contract because the income was derived from the sale of meals, while the expenditure would be incurred under the franchise agreement. For that reason the income-earning and the expenditure-incurring contracts were different and the claim to the allowance failed.

[28] There is no doubt that the income-earning contracts in this case are the initial sale contracts. The ClubCard contract is not a source of income and Clicks no longer contends that it is. Yet, as the main judgment says, the initial sale contracts on their own do not result in Clicks incurring any obligation to the customer. Absent a ClubCard contract and the presentation of a ClubCard at the point of sale, the sale agreements are complete when the customer leaves the store having paid for the goods. Clicks has no further obligation to fulfil under the sale contract. If the customer has concluded a ClubCard contract and presents the card at the point of sale, Clicks incurs an obligation under the ClubCard contract to award them points. Even then it does not incur any expenditure, because it is only if the customer accrues 100 points during a qualification period that they get anything at all. If the customer changes allegiance and shops at one of Clicks' competitors, or changes address and now resides in an area not served by Clicks, their accumulated points will not be used and after a year any vouchers issued will lapse.

[29] It is appropriate at this point to say something about the concept of expenditure in relation to Clicks' claim to the allowance. The 'expenditure' on which Clicks relied was nothing more than its conventional purchases of stock in the ordinary course of its business. It does not purchase any item of stock specifically for the purpose of satisfying its obligations under the loyalty programme. Instead it acquires stock for the purpose of its ordinary trading activities. When customers purchase items and present a rewards voucher in payment for the goods, the value of the voucher is deducted from the overall price and the customer pays the balance. In other words the goods are sold at a discount represented by the amount of the voucher. No expense item is shown in the taxpayer's accounts. Its purchases of stock are accounted for in the usual way by adding purchases to stock on hand at the beginning of the tax year and deducting the stock on hand at the close of the year. In simplified terms that is the primary cost of sales. The discount is

reflected in the fact that sales are less than they would otherwise be by the amount of the discount. But that is no different from the effects of a pensioners' discount on one day of every week, a stock clearance sale or the recently popular 'Black Friday' sale.

[30] I appreciate that in the stated case on which the appeal was argued it was said that Clicks was likely to incur expenditure in that, when a member redeems a reward the appellant supplies goods equal to the value of the reward at no cost to the member. (As noted above, the reality is in almost all cases that the customer receives a discount but still has to pay something for their purchases.) The concession is ambivalently worded and I doubt that it reflects the kind of expenditure contemplated by s 24C. In the paradigm case of a building or manufacturing contract, where a deposit is paid at the commencement of the contract, the amount paid to the builder or manufacturer is needed 'to finance future expenditure in the performance of the contract' such as the purchase of materials needed to perform the contract or the payment of staff. There is, in other words, a direct connection between the amount received and the performance of the contract and the latter will require actual expenditure that, but for the need to perform the contract, would not be incurred. I have considerable difficulty in seeing how perfectly conventional stock purchases – which do involve expenditure – are directly financed by earlier sales, as opposed to being financed out of general revenue. There is no direct connection between the two. If, when the first sale was made, one were to ask what goods were to be purchased with the price paid by the customer in order to satisfy Clicks' obligations under the loyalty programme, the only answer would be that Clicks had no idea and would only know when a later purchase was made and a rewards voucher presented in payment.

[31] If one views the matter from the perspective that the loyalty programme is no more than an undertaking in certain circumstances to afford to customers who present a rewards voucher a discount on the goods they happen to have purchased, this can hardly count as expenditure as contemplated by s 24C. However, in view of the concession in the stated case and the fact that as a result this was not fully argued it is undesirable that I go further than expressing these reservations.

[32] 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. Whether in certain circumstances the requirement of the same contract may be satisfied by two or more connected contracts is not a question that needs to be resolved in this case.

M J D WALLIS
JUDGE OF APPEAL

APPEARANCES:

For the Appellant:	P Ellis SC (with him) RM Molea
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