

The Tax Office targets loyalty programs

Tas Demos, of BDH & Co chartered accountants, looks at how the Tax Office views the common practice of using credit cards that accumulate frequent flyer points to pay business expenses.



Tas Demos

It is common practice for real estate principals to pay expenses ranging from insurance, phone accounts, advertising, stationery and electricity on credit cards that accumulate frequent flyer points that may or may not be redeemed at a later point in time.

Over the years the Australian Taxation Office (ATO) has issued various rulings and practice statements outlining their views on the issue. However, the ATO is now beginning to make noises about taxing the benefits that are received by loyalty program recipients.

The issue

In a practice statement issued by the ATO, they note that the following three scenarios seek special attention by tax officers which may result in the payment of income tax or fringe benefits tax (FBT):

1. The arrangement in relation to the loyalty program is so contrived that it has no commercial purpose other than to allow the recipient to receive the rewards to which they become entitled
2. the nature of the arrangement suggests that the rewards are being received in substitution for income

3. the points accumulated from business expenditure exceeded 250,000 points per annum.

Where an employee receives a reward under a loyalty program, fringe benefits tax may be payable on the benefit received where the provision of the reward has a sufficient and material connection to employment.

For example, an employee may use their credit card to pay the employer's costs which are subsequently reimbursed. By doing this, the employee accrues loyalty program points which can be redeemed for personal benefit. The ATO has stated that such an arrangement may attract FBT on any rewards obtained.

However, where the expenses are incurred on behalf of the employer for legitimate business reasons, FBT would not apply.

For example, where it can be argued that the use of a corporate card results in administrative savings which far outweigh any benefit derived from loyalty programs, it may result in no tax consequences.

Value of flight rewards

Where there is a tax liability in respect of free flights and ticket upgrades, the ATO accepts a valuation of the benefit based on a percentage of the full published fare for all class of tickets. The percentages to be adopted are detailed in a tax ruling, TR 1999/6 (see table one).

The ruling provides that the percentages take into account restrictions applicable to flight rewards in respect of each class of fare.

At what point is that tax paid?

It is the receipt of the benefit which is the taxing point and the value of the reward may be subject to tax. The receipt of points would not be a taxing point, nor is the mere transfer of points from one loyalty program to another.

Examples

Practice statement PS LA 2004/4 issued by the ATO provides a number of examples dealing with the treatment of loyalty benefits. Below are three examples which illustrate the ATO's view on loyalty programs:

Example one

Pamela is a sole trader operating a painting and wallpapering business, and she buys her paint from a paint wholesaler. The wholesaler has a loyalty program that entitles her to points which can be redeemed for shopping vouchers. There is a business relationship between Pamela and the paint wholesaler and it is this relationship that makes Pamela eligible to receive possible benefits.

Pamela redeems her points for vouchers worth \$2500. She uses the vouchers to acquire clothing for herself and her children.

The redemption of points in return for the vouchers valued at \$2500 was as a result of business purchases of paint. The value of vouchers, \$2500, is assessable under section 21A of the ITAA 1936 as the benefit flows from the business relationship Pamela has with the paint

TABLE 1

Flight Rewards	Economy Class	Business/First Class
International	35%	70%
Domestic	45%	70%

supplier. The vouchers are assessable income at the time of receipt. Pamela is required to include \$2500 in her assessable income.

Example two

Pamela is also a member of a credit card loyalty program and she uses her credit card for all her business and personal expenses. The rewards flowing from the redemption of the credit card loyalty program points arise from her relationship with the credit card loyalty program provider, and may be assessable as the relationship has both a personal and business aspect.

It is arguable that Pamela has a business relationship with the financier because she pays fees for the service. Where business expenditure is incurred, the credit card provider is extending credit to her business, so that the rewards she receives under the program in relation to her business expenses are arguably assessable under section 21A of the ITAA 1936.

Unless the items above can be satisfied, it is unlikely that further action would be taken by the ATO.

However, in a further example from the Practice Statement, the ATO is likely to take the view that benefits derived from the use of a credit card may be subject to FBT.

Example three

John is an employee of XYZ Company. John uses his personal credit card for private expenditure. Under an arrangement (which can be explicit or tacit) with his employer, John is able to place all of the business expenditure of the company on his personal credit card.

The company reimburses him for the expenditure he has paid on its behalf. Under the arrangement, John's point entitlement from the business expenditure is significant and exceeds 250000 points per annum.

FBT may apply in this case. Any reward that arises from the redemption of the points has accrued in respect of significant business expenditure. The reward may have been provided under an arrangement, and may be in respect of employment.

Conclusion

In summary, where the facts demonstrate that the rewards received from loyalty programs are accrued through business expenditure, the rewards may be subject to income tax or fringe benefits tax.

This particularly applies where an employee pays business expenses on his or her credit card even though there is no administrative benefit or commercial convenience to the arrangement.

However, where the expenses are incurred by the proprietor or by an employee on behalf of the employer for legitimate business reasons, FBT is unlikely to apply.

In light of the ATO's new focus on loyalty programs, the ATO could easily contact large loyalty providers and require them to disclose all members with large point balances. ■

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