GSTR 2011/D3 - Goods and services tax: loyalty programs

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Draft Goods and Services Tax Ruling

Goods and services tax: loyalty programs

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What this Ruling is about

1. This draft Ruling concerns the goods and services tax (GST) implications of certain loyalty programs.

2. In particular, this draft Ruling considers:

   (a) Whether the allocation of points by the loyalty program operator (or by any entity authorised to allocate points on its behalf) to members is a supply made for consideration;

   (b) Whether a payment from a program partner to the loyalty program operator (or an entity nominated on its behalf) is consideration for a supply;

   (c) To the extent that such a payment is consideration for a supply, how is that supply characterised? Specifically, the draft Ruling considers the implications of such characterisation in determining whether the supply is to any extent GST-free or input taxed;

   (d) Whether the provision of a reward to the member (upon redemption of points by them) is a supply to the member for consideration;

   (e) Whether any payments made by the loyalty program operator (or an entity nominated on its behalf) to a redemption partner is consideration for a supply made by the redemption partner to the loyalty program operator, or is instead consideration for the supply of the reward made to the member; and

(f) Whether the redemption partner makes a supply to the program member, even if it also makes a supply to the loyalty program operator.

3. There are many different loyalty programs, with a range of different features. This draft Ruling only deals with the GST implications of arrangements which have the minimum features set out at paragraphs 7 to 14 of this draft Ruling. In particular, it does not deal with arrangements to the extent that:

- the rewards provided are money;
- an allocation of points is made to a member in response to an activity performed by the member for the benefit of the loyalty program operator; or
- the 'points' are in a form that satisfies the definition of a voucher within the meaning of section 100-25 of *A New Tax System (Goods and Services Tax) Act 1999.*

4. This draft Ruling only deals with GST implications. It does not cover the fringe benefits tax or income tax consequences of loyalty programs.[1]

Interpretation

5. Unless otherwise stated, all legislative references in this draft Ruling are to the *A New Tax* System *(Goods and Services Tax) Act 1999* (GST Act).

6. In this draft Ruling, unless otherwise stated, a reference to:

- a 'member' includes a customer that joins a loyalty program pursuant to a loyalty program membership agreement between them and the loyalty program operator. Members of the loyalty program referred in this draft Ruling are limited to individuals only;
- a 'loyalty program operator' or 'operator' means the entity responsible for the operation of the loyalty program, which has agreements with members and (where applicable) program partners and redemption partners. In some cases, the operator may administer the loyalty program; in other cases it may outsource the administration to a third party;
- a 'points fee' means a fee charged by a loyalty program operator to a program partner for the allocation of points (or bonus points) to customers of the program partner. The fee is charged on a periodic basis and calculated by reference to the number of points or bonus points provided to the program partner's customers. In some loyalty programs, a program partner may be charged other fees in addition to, or instead of, a points fee;

[1] For further information see TR 1999/6; TD 2003/20; TD 1999/34.

- a 'program partner' means an entity that participates in a loyalty program run by the loyalty program operator, upon payment of a points fee. In some cases a program partner is also a redemption partner;
- a 'redemption partner' means an entity that is engaged by the loyalty program operator to provide rewards to members of the loyalty program. In some cases a redemption partner is also a program partner;
- 'loyalty points' is a reference to any record-keeping mechanism (usually, but not necessarily, called points) which is used to ascertain the member's eligibility for rewards. However, it does not include rights to goods or services in the form of vouchers within the meaning of section 100-25; and
- 'redemption of points' is a reference to the exchange by a member of loyalty points for goods or services. The goods or services may be provided by a redemption partner or the loyalty program operator.

Class of Arrangement

7. This draft Ruling applies to loyalty program operators and members. It also applies to program partners and redemption partners, where the loyalty program involves such entities.

8. This draft Ruling applies to arrangements whereby a loyalty program is established by the loyalty program operator and governed by an arrangement between the loyalty program operator and the member that, as a minimum, has the following features:

- the loyalty program operator provides the member with loyalty points as a consequence of the member purchasing eligible goods or services or using a credit card to make such a purchase;
- the price paid by the member for making eligible purchases is the same as for a non-member (that is they do not pay anything extra for the loyalty points);
- the loyalty points cannot be transferred for money;
- the loyalty points cannot be redeemed for money;
- to the extent that points may notionally have a value for program members, the value of points earnt in making eligible purchases is low compared to the price of the goods or services themselves (that is the value might be 10% of that of the goods or services);
- there is a record-keeping mechanism in place that allows the loyalty program operator, member or both, to track how many loyalty points have accrued; and

- the points may be redeemed at some time for a reward, being goods or services or a right to receive goods or services. The actual reward depends on the number of points accrued and redeemed by the member. Accordingly, the greater the number of points redeemed, the more valuable the reward to the member is likely to be.

9. Other features of some arrangements include:

- the expiry of points after a period of time; and
- the ability of members to make an additional payment to obtain a reward where they have insufficient points (sometimes known as points plus pay).

10. The draft Ruling also applies in relation to loyalty programs that involve program partners if the minimum criteria in paragraph 8 are satisfied. This involves the loyalty program operator and the program partner entering into an agreement (participation agreement) which involves the payment of a points fee by the program partner to the loyalty program operator (or a nominated entity) on a regular basis.

11. The agreement may also provide for other fees to be payable by the program partner. This could include fees for services such as marketing, promotion or administration.

12. There are also cases where the program partner has its own loyalty program and there is an agreement with the loyalty program operator for points to be transferred from one program to the other.

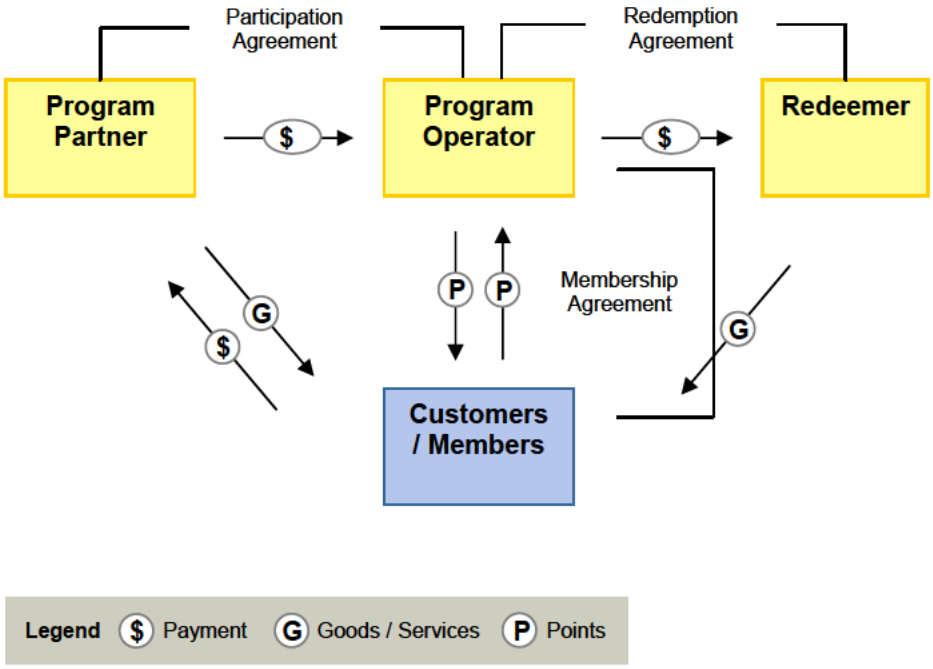
13. This draft Ruling also applies in relation to loyalty programs that involve redemption partners if the minimum criteria in paragraph 8 of this draft Ruling are satisfied. Where a loyalty program operator has redemption partners, there are the following features:

- there is a contract between the loyalty program operator and each redemption partner pursuant to which the redemption partner will supply rewards, either to program members or the loyalty program operator; and
- the loyalty program operator will make payments to the redemption partner in respect of the provision of rewards.

14. If an entity is both a program partner and a redemption partner, a single payment between the program partner/redemption partner and loyalty program operator may be made on a periodic basis, which is a net payment of a points fee and an amount for the provision of rewards.

15. The basic structure of loyalty programs involving program partners and redemption partners is illustrated as follows:

Basic Structure of a Multi-Party Loyalty Program



Ruling

Accrual of points by members

16. The allocation of points to a member of a loyalty program when the member purchases goods or services is not in itself a supply to the member for consideration. The price the member pays is consideration for the goods or services the member acquires.

Loyalty program arrangements involving program partners

17. There may be one or more supplies made by a loyalty program operator to a program partner.

18. A 'points fee' (as defined in paragraph 6 of this draft Ruling) paid by a program partner is consideration for a supply by the operator to the program partner of those points which are provided by the operator to the program partner's customers.

19. This constitutes a supply of 'rights', being the rights that program members obtain on receiving points. Supplies to the program partner for which a points fee is consideration:

- are GST-free to the extent that the points would be redeemed for supplies which are GST-free (paragraph 9-30(1)(b)); and
- are input-taxed to the extent that the points would be redeemed for supplies which are input taxed (paragraph 9-30(2)(b)).

20. If a supply to a program partner for which a points fee is consideration meets the conditions in subsection 38-190(1), that supply is not GST-free under section 38-190 to the extent that points would be redeemed for supplies which are connected with Australia and would not be GST-free (subsection 38-190(2)). Since the points are provided to program members, subsections 38-190(3) and (4) need to be taken into consideration in applying items 2 and 3 in the table in subsection 38-190(1).

21. Where the program partner makes a payment other than a points fee to the operator, it may be consideration for a different supply, or for a separately identifiable component of a mixed supply. The facts of each arrangement determine the characterisation of the relevant supply. Given the breadth of potential arrangements, this draft Ruling does not deal with this characterisation issue.

22. To the extent that the supply by the operator to the program partner is a taxable supply, and the elements of section 11-5 are met, the program partner makes a creditable acquisition from the loyalty program operator and is entitled to an input tax credit in accordance with Division 11.

Redemption of points and provision of rewards

23. Where a member obtains a reward, a supply is made to the member.

24. The redemption of points by a member is not consideration for the supply of a reward to the member. Accordingly, the supply of the reward can only be a taxable supply to the member where additional consideration is provided.[2]

25. When a redemption partner provides goods or services to the member upon redemption of points (or upon redemption of points plus additional consideration) under a contractual arrangement between the redemption partner and the loyalty program operator, the redemption partner also makes a supply to the loyalty program operator. A payment from the loyalty program operator to the redemption partner, in return, is consideration for this supply.

[2] Except where the member is an associate, in which case Division 72 may apply.

26. The supply is properly characterised as a supply of the underlying rewards (for example goods or services) provided to members. Whether the supply is GST-free or input taxed needs to be determined accordingly. Where the reward is a face value voucher,[3] the supply of the voucher to the operator (provided to the member) is not a taxable supply in accordance with section 100-5.[4]

27. Where the elements of section 11-5 are met, the loyalty program operator makes a creditable acquisition from the redemption partner and is entitled to an input tax credit in accordance with Division 11.

Examples

Example one – no GST on loyalty points

28. *Larry is a member of the Loyalty Plus program which has all the features of the arrangement set out at paragraphs 7 to 14 above. Larry purchases some clothes from Anna's, a large retail store and a program partner of Loyalty Plus. Larry pays $110 for the clothes and swipes his Loyalty Plus card, which triggers the allocation of 20 points from Loyalty Plus to him. The only taxable supply to Larry is the supply of the clothes by Anna's to Larry, with GST of $10 payable. While points are provided by Loyalty Plus to Larry, none of the $110 paid by Larry is consideration for the supply of points.*

29. *Larry subsequently makes a number of other purchases in respect of which he earns points on the Loyalty Plus card. A few weeks later, after browsing the Loyalty Plus website, Larry realises that he has enough points for the reward of a monthly bus ticket. He selects an option on the Loyalty Plus website to redeem his points for the bus ticket. He does not pay any amount for the bus ticket.*

30. *Whilst Larry is the recipient of a supply of a bus ticket, it is not a taxable supply to him because it is not for consideration.*

Example two – payment of a 'points fee'

31. *Ace Loyalty Co runs a loyalty program. It enters into a participation agreement with Sunshine Co which provides, amongst other things, that Ace will allocate points to its members whenever they purchase goods or services from Sunshine. In return, Sunshine agrees to pay a points fee calculated on the number of points allocated to members upon purchase of goods or services from Sunshine. The agreement also provides that at the end of each stipulated period, Ace Loyalty Co will invoice Sunshine for the fees payable, but that the fees are to be paid directly to the trustee of Ace Loyalty Co Trust. Ace Loyalty Co Trust funds rewards provided by Celestial Co.*

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[3] This term takes the meaning it has in GSTR 2003/5.

[4] These circumstances are not the same as those outlined at paragraphs 139-146 of GSTR 2003/5. Rather, the payment by the operator to the member is for a supply of a voucher made to the operator (but provided to the member).

32. *A supply for consideration is made by Ace Loyalty Co to Sunshine Co consisting of the provision of points to Celestial Co members. The fact that payments by Sunshine Co are to the trustee of Ace Loyalty Co Trust does not affect this conclusion.*

Example three – supply to overseas program partner

33. *Loyalty Co, a loyalty program operator in Australia, enters into a participation agreement with a program partner Overseas Co, a non-resident.*

34. *As part of the participation agreement, points are allocated to members of Loyalty Co when they acquire the relevant goods or services from Overseas Co, in return for which they pay a points fee to Loyalty Co. The supply to Overseas Co is characterised as a supply of rights. It is covered by item 4 of subsection 38-190(1). Loyalty Co offers a range of rewards to its members, the supply of which, in many cases, be connected with Australia and would not be GST-free.*

35. *Although the supply is covered by items 4 of subsection 38-190(1), subsection 38-190(2) negates the GST-free status of the supply to Overseas Co to some extent. Firstly, the supply of the right to Overseas Co is a right for members of the program to receive rewards. Secondly, as some of the supplies of rewards to members, if made, would be connected with Australia and would not be GST-free, the supply of the right to Overseas Co is not GST-free to that extent.*[5]

Example four – points fee partly for rights to receive a GST-free supply

36. *XYco runs a loyalty program and enters into participation agreement with Whyco, a GST-registered entity that operates an enterprise in Australia. Under the agreement, XYco agrees to allocate points to its members when they acquire eligible services from Whyco, in return for which Whyco pays Xyco a points fee. Under the membership agreement that XYco has with its members, it offers a suite of rewards, including international travel.*

37. *The supply by XYco to Whyco is a supply of rights, which are provided to Whyco's members. To the extent that points would be redeemed for rewards that consist of international travel that is GST-free under section 38-355, the supply to Whyco is GST-free under paragraph 9-30(1)(b).*

[5] Item 2 of the table in subsection 38-190(2) may also be applicable. However, it would be necessary to consider the operation of both subsections 38-190(2) and 38-190(3).

Example five – supply by a credit card operator to a bonus partner

38. *AmyBank is a financial institution which operates a loyalty program that provides points to its credit card holders whenever they use their credit card to make purchases of goods or services. AmyBank enters into a participation agreement with John's Supermarkets. Under the terms of the participation agreement, in return for John's paying AmyBank a regular points fee, calculated by reference to the number of points allocated to its customers, AmyBank allocates bonus points to their credit card holders whenever they use their credit card to purchase goods or services from John's. AmyBank also undertakes under the agreement to promote John's Supermarkets by distributing marketing material to AmyBank's credit card users alerting them to the bonus offer and the goods that can be purchased at John's Supermarkets. John's Supermarkets pays AmyBank an additional monthly fee for this promotion.*

39. *AmyBank supplies John's Supermarkets rights, which are provided to John's Supermarkets' customers. The points fee is consideration for this supply. AmyBank also supplies promotional services to John's Supermarkets and the additional monthly fee is consideration for these promotional services.*

Example six – loyalty program operator makes acquisition from redemption partner

40. *Elissa Pty Ltd (Elissa) is a loyalty program operator. It enters into a contract with the redemption partner Reg Pty Ltd (Reg) under which Reg, for a pre-determined fee, is to provide jewellery to members as rewards. Member Andrea, a resident, redeems sufficient points to enable her to obtain the reward of a bracelet. Reg provides the bracelet to Andrea, while Elissa pays Reg the fee stipulated in the contract.*

41. *Reg makes a supply of jewellery to Elissa, which is provided to Andrea. Assuming all the other elements of section 11-5 are met, Elissa makes a creditable acquisition of the bracelet and is entitled to an input tax credit.*

Example seven – loyalty program operator makes acquisition of voucher from redemption partner

42. *Far Out Ltd (Far Out) is a loyalty program operator. It enters into a contract with redemption partner Red Pty Ltd (Red) for Red, for a pre-determined fee, to provide rewards to members. Member Debbie, a resident, redeems sufficient points to enable her to obtain the reward of a face value voucher worth $110. Red provides the voucher to Debbie, while Far Out pays Red the fee for the voucher stipulated in the contract.*

43. *Red makes a supply of the voucher to Far Out, which is provided to Debbie. Section 100-5 applies such that the supply by Red to Far Out is not a taxable supply. Accordingly, Far Out has not made a creditable acquisition within the meaning of section 11-5 and is therefore not entitled to an input tax credit.*

Date of effect

44. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

45. The ATO would welcome comments on whether any transitional arrangements are warranted when the final Ruling is issued.

Commissioner of Taxation
24 August 2011

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Accrual of points by members

46. When a member makes an acquisition of eligible goods or services from a loyalty program operator or a program partner, the member is allocated points.

47. A question arises as to whether any GST implications arise from the allocation of points to members. In this context, it is necessary to consider whether there is a 'supply' of points.

48. The term 'supply' is broadly defined in section 9-10, including the extended meaning given to it by subsection 9-10(2). Under the terms of the member agreement, the loyalty program operator is required to allocate the points to members when they acquire the eligible goods or services. Additionally, while the points themselves do not have any inherent monetary value, they can be redeemed for a reward (whether immediately upon purchase or at a later time).

49. A supply includes a grant of rights.[6] The question of whether points are something that is 'supplied' turns on whether they represent binding 'rights' that members of the program have, or merely give rise to expectations.[7]

50. In the arrangements subject to this draft Ruling, there is an agreement between the loyalty program operator and member under which points are allocated, and these points can be redeemed for rewards on offer. There are enforceable rights that are conferred on the loyalty program member and corresponding obligations on the part of the operator. Principally, the rights are for the redemption of points for rewards. In some cases there is a significant discretion held by the loyalty program operators to change the rewards on offer, disqualify members in certain circumstances and even suspend or terminate the relevant loyalty program. Nevertheless, program members do have binding rights, even though in some loyalty programs those rights may be affected by subsequent actions of the operator.[8]

51. The next step is to determine whether the supply of points is a supply to members for consideration where points are allocated to the member when they acquire eligible goods or services.

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[6] Paragraph 9-10(2)(e); an entry into an obligation to do anything is also a supply under paragraph 9-10(2)(g).
[7] See GSTR 2006/9, paragraphs 102 to 111.
[8] Note that in *Re ANSETT AUSTRALIA LTD and Others (all administrators appointed) and MENTHA and Another (as administrators)* (2002) 115 FCR 395, (2002) 188 ALR 186, [2002] FCA 2 it was accepted that members of the Ansett frequent flyer program were creditors of the company.

52. To answer this question, it is important to understand the transaction which takes place. When the member purchases eligible goods or services, they purchase them for face value like any non-member but, in addition to the relevant goods or services, get an allocation of points. Although the allocation of points is a supply of rights,[9] the member does not pay anything extra to obtain these points. Properly construed, there is not a supply of rights to the member for consideration.[10]

53. This is in contrast to Case 6/2007 [2007] AATA 1550[11] (*Food Supplier*) where it was found that the consideration was attributable to the whole of the package consisting of both the food items and non-food items.

54. Additionally, in many cases, the supply of points is incidental to the supply of the goods or services; it represents a marginal proportion of the total value of the supply. In this regard, refer to Goods and Services Tax Ruling GSTR 2001/8.[12]

Loyalty program arrangements involving program partners

55. Some loyalty programs involve participation in the loyalty program by program partners. This is governed by a participation agreement between the loyalty program operator and the program partner. Members of the program can earn points not just by making purchases from the loyalty program operator, but also through purchases from program partners.

56. From the perspective of a loyalty program operator, admitting program partners into the loyalty program can be desirable as it increases the attraction of the program to members, with flow on benefits to the loyalty program operator. The loyalty program operator may also obtain a direct financial return by receiving fees paid by the program partner pursuant to the agreement.

57. From the perspective of a program partner, participation in the loyalty program may be beneficial in attracting customers.

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[9] Whether it is a separate supply or a separately identifiable part of a mixed supply which includes the underlying goods or services.

[10] It is noted, however, that Australian Accounting Standards Board, *AASB Interpretation 13: Customer Loyalty Programs*, in conjunction with *AASB 118*, paragraph 13, requires deferral of some revenue where loyalty award credits are issued.

[11] 2007 ATC 157, 99 ATR 938.

[12] GSTR 2001/8 apportioning the consideration for a supply that includes taxable and non-taxable parts.

58. Having regard to the participation agreement between the loyalty program operator and program partner and the benefits of participation in the loyalty program that flow to the program partner, a supply or supplies are made by the loyalty program operator to the program partner. The points fee and other fees paid by the program partner are consideration for that supply or those supplies. In some arrangements, the points fee must be paid by the program partner to an entity nominated by the operator (such as a trust which funds the provision of rewards to members).[13] This does not alter the conclusion that the points fee is consideration for a supply by the operator to the program partner.

59. The GST consequence of a supply made by the loyalty program operator depends on how the supply is characterised. Depending on the nature of the supply, the supply could be either taxable, input taxed or GST-free.[14]

Characterising the supplies that are made

60. In characterising the supply or supplies for consideration that the loyalty program operator makes to the program partner, the logical starting point is the contract between the two entities. The context of the loyalty program as a whole should be also taken into account, including other documents that are relevant to the operation of the loyalty program, such as the loyalty program membership agreement.

61. In *Saga Holidays Limited v. FCT*,[15] Stone J took the view that it was appropriate to look at the 'social and economic reality' of a transaction in determining whether there is a single supply or more than one supply.[16]

62. In determining the nature of the supply between a loyalty program operator and a program partner, the Tax Court of Canada took a similar approach in the *Royal Bank of Canada v. The Queen*[17] case, holding that

> It is always a question of fact as to how GST will be applied in the context of a particular affinity or loyalty program. While the contractual agreements relating to the program and the actual manner in which the program is conducted will generally dictate how GST will be applied, it is always open for a Court in each case to determine the substance of the supply for which consideration was paid.[18]

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[13] See Administrative Appeals Tribunal decision in *Keenhilt Pty Ltd and FC of T* [2007] AATA 2095, (2007) 67 ATR 988, (2007) ATC 2794.
[14] There may also be cases where the supply is not connected with Australia, but this is not considered in the draft Ruling.
[15] [2006] FCAFC 191.
[16] [2006] FCAFC 191 at paragraph 43 of the judgement.
[17] 2007 TCC281.
[18] Paragraph 42 in *Royal Bank of Canada v. The Queen* 2007 TCC281.

63. This draft Ruling concerns arrangements whereby a fee (in this draft Ruling called a 'points fee') is charged by the loyalty program operator to a program partner. The fee is charged on a periodic basis and calculated by reference to the number of points or bonus points provided to the program partner's customers. Moreover, the fee is said to be payable for the allocation of those points.

64. The points fee is consideration for the operator allocating points to the program partner's customers.

65. This is consistent with the analysis of Supreme Court of Victoria, and subsequently the Victorian Court of Appeal, in the context of an agreement between Ansett Airlines and Diners Club in respect of the Ansett frequent flyer program.[19]

66. At paragraphs [18] to [19], Maxwell P said:

> [W]hat Ansett agreed with DC [Diners Club] was to give DC cardholders entry to the GR [Global Rewards] program on a special basis. Unlike other members of the GR program, DC cardholders would be credited with points, not for making purchases of airline tickets from Ansett or one of its partners but for making purchases on the DC card, being purchases from which DC itself would earn 'substantial' commission income. Ansett's giving of that promise enabled DC to offer that special GR access to prospective DC cardholders as an incentive to their becoming cardholders, and to existing DC cardholders as an incentive to their making greater use of their DC cards for purchases. As DC said in its opening at the trial, the ability of members to earn 1.5 GR points for every dollar spent on a DC card was 'the key reason why people became Diners members, and the key driver behind Diners' turnover'.
>
> DC therefore agreed that it would make a payment to Ansett, not in consideration of Ansett promising to maintain the program but in consideration of Ansett's crediting of each GR point earned by a DC cardholder.

67. At paragraph [38], Maxwell P concluded:

> In no contractual sense was DC paying for the awards which were available to DC cardholders when, in their capacity as GR members, they redeemed the points which they had thus earned. The fact that Ansett used funds paid by DC under the agreement to defray the expenses of the GR program could not affect this conclusion.

68. Where there is a payment that is expressed as being for the allocation of points, and calculated by reference to the points allocated, the better view is that the payment is consideration for a supply to the program partner consisting of the provision of points, and thus rights, to members.

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[19] *Diners Club Pty Ltd v. Ansett Australia Limited* [2008] VSCA 30.

69. This is not to deny that there may be other payments by the program partner that are properly construed as consideration for other supplies, including specific services of the operator, or even ongoing participation in the loyalty program. Ultimately, the facts of each arrangement determine whether there are other supplies (or separately identifiable components of a mixed supply) that are made for consideration.

Is the points fee paid for the supply of an interest in a Managed Investment Scheme

70. In some cases, a loyalty program may be construed as a managed investment scheme.[20] The supply of an interest in a managed investment scheme[21] is (subject to certain exceptions) an input taxed supply.[22]

71. It follows that if a loyalty program constitutes a managed investment scheme, the provision of interests in the loyalty program could be a financial supply if the provision is for consideration, is done in the course or furtherance of an enterprise, and is connected with Australia.

72. However, the points fee is properly construed as paid by the program partner for the allocation of rights to members. In contrast, it is not paid for the supply of an interest in a managed investment scheme.

73. Accordingly, the points fee is not for a supply of an interest in a managed investment scheme. If, in the context of a particular loyalty program, a payment is made by the program partner, not for the allocation of rights, but for an ongoing interest in the loyalty program, it may be necessary to consider whether the payment is for the supply of an interest in a managed investment scheme.

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[20] This draft Ruling does not deal with the circumstances in which the loyalty program would be construed as a managed investment scheme. It is noted that ASIC has provided in Class Order 05/737 relief for loyalty schemes from registration as managed investment schemes under Chapter 5C of the Corporations Act. However, this exemption does not affect the potential classification of the scheme as a managed investment scheme for the purposes of the GST Act.

[21] For this purpose, managed investment scheme takes its meaning from section 9 of the *Corporations Act 2001*.

[22] The provision, acquisition or disposal of an interest mentioned in subregulation 40-5.09(3) or (4) of the A New Tax System (Goods and Services Tax) Regulations (GST Regulations) is a financial supply where it meets the requirements of subregulation 40-5.09(1) of the GST Regulations. Item 10 in the table in subregulation 40-5.09(3) of the GST Regulations includes an interest in or under securities. Securities are defined in the GST Regulations to take the meaning provided in subsection 92(1) of the *Corporations Act 2001* (Corporations Act). Paragraph 92(1)(c) of the Corporations Act provides that 'interests in a managed investment scheme' are securities for the purposes of that Act.

Whether the supply to program partner is GST-free or input-taxed

74. The points fee is consideration for a supply from the loyalty program operator to the program partner that is characterised as a granting of rights to the program partner. This supply is GST-free or input taxed to the extent that it is GST-free under Division 38 or paragraph 9-30(1)(b) or input-taxed under Division 40 or paragraph 9-30(2)(b).

Supply of a right to receive a GST-free or input-taxed supply

75. Paragraph 9-30(1)(b) provides that a supply is GST-free if it is a supply of a right to receive a supply that would be GST-free under Division 38 or a provision of another Act. Paragraph 9-30(2)(b) provides a complementary rule for rights to receive input taxed supplies.

76. The essence of points is that, subject to certain conditions, the holder of the points has a right to redeem them in return for rewards. Hence, points may be described as rights to receive supplies.

77. Although the program partner does not receive the points themselves, rather program members receive the points, the points are granted pursuant to the contract between the operator and the program partner. Hence, what is supplied to the program partner are the points (the rights to receive supplies), which are provided to members.

78. In some loyalty programs, points may be redeemed by members for GST-free or input-taxed supplies. The test under paragraph 9-30(1)(b) and (2)(b) is whether the points represent a right to receive a supply that *would be* GST-free or *would be* input-taxed. This requires a prediction, when the points are allocated, of the extent to which they would be redeemed for GST-free or input-taxed supplies.

79. The operator needs to work out the extent to which the points would be redeemed on some fair and reasonable basis. It may be reasonable for the loyalty program operator to determine how the rights (points) would be redeemed by reference to the history of how rewards had been redeemed in the program – although any changes in the nature of the program and the rewards offered to members should be considered.

80. The focus in paragraphs 9-30(1)(b) and (2)(b) is on the supplies that are to be received. Particular rights may not be redeemed by members for supplies. In determining the extent to which the allocation of points is GST-free or input-taxed, points that will never be redeemed should be omitted from the calculation. So, if under a participation agreement, an operator allocates 1.5 million points and reasonably estimates that 1 million of these points will be redeemed, of which it reasonably estimates that 300,000 will be

redeemed for GST-free supplies, the supply of rights to the program partner is 30% GST-free.

81. As paragraphs 9-30(1)(b) and 2(b) require some prediction as to the future GST-free or input taxed use of the points, it may be that the actual use of the points differs from the predicted use. In these circumstances, provided the predicted use of the points is calculated on a fair and reasonable basis, the fact that there is a difference does not mean that the GST payable on the supply was overstated or understated.

Alternative views

82. An alternative view is that the supply to the program partner is not capable of coming within paragraphs 9-30(1)(b) and 9-30(2)(b).

83. A requirement in paragraphs 9-30(1)(b) and (2)(b) is that there is a right to receive a supply. In a particular loyalty program there might strictly be no right to receive **any** supply until a certain amount of points has been accumulated by the member. Nevertheless, we do not think a narrow construction of 'right to receive a supply' should be preferred. The broader view is preferred that points represent rights to receive a supply, even if they can only be effectively utilised in conjunction with further points that the member may accumulate, or in conjunction with the payment of money.

84. Another argument against the application of paragraphs 9-30(1)(b) and (2)(b) is that the words 'would be GST-free' in paragraph 9-30(1)(b) and 'would be input taxed' in paragraph 9-30(2)(b) require the 'something' which is the subject matter of the supply of the right to receive, to be specifically identified at the time of the supply of the right. We do not agree. We think that it is reasonable to construe the words 'would be' as extending to a situation where it can be predicted that the rights would be used to some extent to acquire GST-free or input-taxed supplies.

85. A further argument against the application of paragraphs 9-30(1)(b) and (2)(b) in these circumstances is that there may be an implication that the entity that is the recipient of the supply of rights to receive needs to be the same entity that would exercise those rights to receive the GST-free or input-taxed supply. However, we think the better construction is that these provisions are capable of operation in circumstances where the relevant rights are supplied **to** the program partner, but **provided** to program members who exercise those rights.

Supplies for consumption outside Australia

86. The supply to the program partner is also GST-free to the extent that section 38-190 applies.

87. Subsection 38-190(1) comprises of five items which sets out supplies of things, other than goods or real property, that are

GST-free. A supply that is not GST-free under one item in the table in subsection 38-190(1) may be GST-free under another of the items. If the requirements of any of those items are met, the supply is GST-free, provided that subsection 38-190(2), (2A) or (3) does not negate the GST-free status of the supply.

88. A supply by the loyalty program operator to the program partner (other than a supply of goods or real property) may be GST free under items 2, 3 or 4[23] of subsection 38-190(1). In particular, where the program partner is a non-resident, who is outside Australia when the rights are granted, item 4(b) may apply.

89. Since the rights are supplied to program partners and are provided to program members, if item 2 in subsection 38-190(1) applies, it is necessary to take into account subsection 38-190(3). Subsection 38-190(3) will prevent a supply being GST-free under item 2, where the rights are provided to the program member in Australia.[24]

90. For the same reasons, in applying item 3 in the table in subsection 38-190(1), it is necessary to consider subsection 38-190(4).

Sub-section 38-190(2)

91. Subsection 38-190(1) is qualified by subsection 38-190(2) which provides that a supply covered by any of items 1 to 5 is not GST-free to the extent that the supply is a supply of a right or option to acquire something the supply of which would be connected with Australia and would not be GST-free. Hence, to the extent that points would be used by members to acquire rewards which would be connected with Australia and would not be GST-free, the supply of those points (that is, rights) is not GST-free under any of items 1 to 5.

92. We consider that the words 'would be' connected with Australia and 'would not be' GST-free in subsection 38-190(2) should be given a similar construction to the words 'would be' GST-free or input taxed in paragraphs 9-30(1)(b) and (2)(b) respectively. That is, the provision requires a prediction, when the points are allocated, of the extent to which they would be redeemed for supplies that would be connected with Australia and would not be GST-free. The alternative views referred to at paragraphs 82 to 85 could also be advanced in respect of subsection 38-190(2) but are not preferred by the Commissioner for the same reasons indicated in respect of section 9-30.

[23] It is much rarer that item 1 will be applicable in a loyalty program context.

[24] However, in many cases this may not have a practical effect because item 4(b) in the table in subsection 38-190(1) may also apply. That is, subsection 38-190(3) does not apply to a supply covered by item 4. However, subsection 38-190(2) may apply to negate the GST-free status of the supply.

Redemption of Points by Member

93. Under the loyalty program arrangement, once the member has accumulated sufficient points, they can redeem those points for a reward. The nature and scope of things that can constitute rewards depends on the particular loyalty program. However, it is commonplace for the larger programs to offer an extensive range of goods, services and vouchers that can be redeemed by the member as a reward.

94. Typically, when a member decides they have accumulated sufficient points to redeem a particular reward, they will notify the loyalty program operator (or the nominated entity that manages the program) of their desire to redeem the points for the reward. The loyalty program operator then arranges for the reward to be provided to the member (whether directly or by the redemption partner).

95. In some loyalty programs, a member may redeem their reward directly from redemption partners by producing (say) an electronic membership card and redeeming the requisite number of points for the relevant reward. In cases where the member does not have sufficient points to acquire the relevant goods or services, they may be permitted to provide additional consideration (this is generally known as points plus pay).

Is the Reward a supply to the member?

96. Whatever the mechanism for the receipt by the member of the reward, where a member obtains a reward, a supply is made to them. This will be so whether the reward is provided to them directly by the operator (or a nominee acting on the operator's behalf) or by a redemption partner pursuant to a contractual arrangement with the loyalty program operator. Where the reward is provided directly by the redemption partner to the member, the actual flow of the supply is from the redemption partner to the member while the contractual flow is from the redemption partner to the loyalty program operator.[25]

Is it a taxable supply?

97. Whether the supply of the reward to the member is a taxable supply to them depends on whether there is any consideration for the supply. If the member does not provide additional consideration for the reward (that is they redeem sufficient points to obtain the reward), the member does not provide any monetary consideration for the supply of the reward.

[25] See Proposition 13 of GSTR 2006/9: paragraphs 130-176.

98. We consider that the redemption of points is not consideration for the supply of rewards to the member. The redemption of points is merely the exercise of a contractual right and not the provision of consideration. The points do not have any inherent value or independent identity such that they are compensation for the supply of the rewards.[26] Moreover, paragraph 9-15(3)(a) provides that:

> … if a right or option to acquire a thing is granted, then:
>
> - the consideration for the supply of the thing on the exercise of the right or option is limited to any additional consideration provided either for the supply or in connection with the exercise of the right or option; or
> - if there is no such additional consideration- there is no consideration for the supply.

99. When the member redeems points in exchange for a reward, they are exercising their right to the supply of the reward. In accordance with sub-paragraph 9-15(3)(a)(i), the consideration for the supply of the thing (the reward) is limited to any additional consideration provided either for the supply or in connection with the exercise of the right. Where the member redeems their points for the reward without providing additional consideration (that is it is not a points plus pay situation), the supply of the reward is not a supply to the member for consideration.

100. Accordingly, the supply of the reward to the member is only a taxable supply where additional consideration is provided and the other elements of section 9-5 are met (including that the supply is not GST-free or input-taxed).

Does a redemption partner make a supply to the Loyalty Program Operator when it provides rewards to program members?

101. In some loyalty programs there is an agreement between the operator and a redemption partner, under which members can directly acquire goods or services from the redemption partner on redemption of points. Under such an agreement, the operator pays the redemption partner for the provision of those goods or services (whether or not there is any separate amount payable by the member under a points plus pay arrangement).

102. In these circumstances we consider that an acquisition is made by the operator pursuant to a contract between the parties and the payment by the loyalty program operator is consideration for the provision of the reward.

[26] See paragraph 81 of GSTR 2001/6.

103. Where the member pays consideration, in addition to redeeming points, there may be two taxable supplies, one to the member and one to the loyalty program operator.[27]

104. This conclusion, that the one set of actions by the redemption partner can be a supply both to the member and to the program partner, is consistent with the decision in *Commissioner of Taxation v. Secretary to the Department of Transport (Vic)*,[28] where it was held that taxi drivers made a supply not just to their passengers, but also to the Department which paid part of the fare.

105. The character of what is provided to the member may assist with the characterisation of the thing supplied under the contract between the loyalty program operator and the redemption partner (see Proposition 13 of GSTR 2006/9). This may be relevant in determining, for example, whether the supply by the redemption partner to the loyalty program operator is GST-free or input-taxed. For example, where the reward is food provided to the member (that does not fall within the exclusions in section 38-3), the supply by the redemption partner to the operator is GST-free.

106. Where the reward is a face value voucher,[29] the supply of the voucher to the operator (provided to the member) is not a taxable supply in accordance with section 100-5.[30]

107. Where the supply made by the redemption partner to the loyalty program operator is a taxable supply, the loyalty program operator makes a creditable acquisition, if all the other elements of section 11-5 are met.

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[27] See also Proposition 15 of GSTR 2006/9. This differs from the approach of the European Court of Justice in the cases of *Baxi Group Ltd* [2010] EUECJ C-55-09 and *Loyalty Management UK Ltd*. [2010] EUECJ C-53/09. For example, in *Loyalty Management UK*, the court concluded that 'payments' made by the operator of the scheme concerned to redeemers who supply loyalty rewards to members must be regarded as being consideration, paid by a third party, for a supply of goods to those members or, as the case may be, a supply of services to them…'

[28] 2010 ATC 20-196; 76 ATR 306, FCAFC 84 at paragraph 56.

[29] This term takes the meaning it has in GSTR 2003/5.

[30] We do not consider that these circumstances are similar to those outlined at paragraphs 139-146 of GSTR 2003/5. Rather, the payment by the operator to the member is for a supply of a voucher made to the operator (but provided to the member).

Appendix 2 – Your comments

108. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

109. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the ATO Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **7 October 2011**

Contact officer: **Gregory Vitulano**

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Appendix 3 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

GSTR 2001/6; GSTR 2001/8; GSTR 2003/5; GSTR 2006/9; GSTR 2007/2; TR 1999/6; TR 2006/10; TD 2003/20; TD 1999/34

Subject references:

- acquisition
- apportionment
- composite supply
- consideration
- creditable acquisition
- GST
- GST-free
- input tax credits
- input tax supplies
- input taxed
- mixed supply
- multi-party arrangements
- recipient
- supplier
- supply

Legislative references:

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- Corporations Act 2001

Case references:

- Baxi Group Ltd v Revenue and Customs Commissioners [2008] BVC 189; [2007] EWCA Civ 1378
- Commissioner of Taxation v Secretary to the Department of Transport (Victoria) [2010] FCAFC 84; (2010) 76 ATR 306; 2010 ATC 20-196.
- Diners Club Pty Ltd v. Ansett Australia Limited [2008] VSCA 30.
- Keenhilt Pty Ltd and FC of T [2007] AATA 2095; (2007) 67 ATR 988; 2007 ATC 2794.
- Loyalty Management UK Limited v The Commissioners to Her Majesty's Revenue and Customs [2007] EWCA Civ 938
- Royal Bank of Canada v. The Queen 2007 TCC281
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