TR 98/D9 - Income tax and fringe benefits tax: flight rewards received under frequent flyer and other similar consumer loyalty programs

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Draft Taxation Ruling

Income tax and fringe benefits tax: flight rewards received under frequent flyer and other similar consumer loyalty programs

other Rulings on this topic

TD 98/D10; TD 98/D11

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What this Ruling is about

1. This Ruling sets out the tax implications of flight rewards (see paragraph 2) received from consumer loyalty programs (see paragraph 3) following the decision of Foster J of the Federal Court in *Payne v. FC of T* (1996) 66 FCR 299; 96 ATC 4407; (1996) 32 ATR 516 (*Payne's* case). Rewards other than flight rewards, are not considered in this Ruling.

2. For the purposes of this Ruling, a 'flight reward' is a free flight (including a free holiday package), a flight upgrade, or free hotel accommodation or car hire that may attach to such free flights or paid flights. Flight rewards can only be taken by the member or an immediate family member (spouse, child, grandchild, parent, grandparent, etc.). Flight rewards are not transferable or redeemable for cash.

3. For the purposes of this Ruling, a 'consumer loyalty program' is a marketing tool operated by a supplier of goods or services (including credit card providers), or a group of such suppliers, to encourage customers to be loyal to the supplier(s). The standard features of these programs are:

(a) the customer is dealing with the supplier in a personal capacity, that is, in accordance with the normal arm's length commercial relationship that exists between consumers and suppliers;

(b) membership is restricted to natural persons;

(c) membership of the program is usually by application, which may require an application fee and/or annual fees;

(d) points are received with each purchase of goods or services;

(e) members and non-members pay the same amount for the goods or services purchased; and

(f) points are redeemable for goods or services.

4. The taxation implications considered by this Ruling are:

(a) whether there is a liability for fringe benefits tax ('FBT') under the *Fringe Benefits Tax Assessment Act 1986* ('FBTAA') for employers in respect of flight rewards received by employees; and

(b) whether a flight reward received by a recipient is assessable under sections 6-5 or 6-10 of the *Income Tax Assessment Act 1997* ('the Act').

Class of person/arrangement

5. This Ruling applies to:

(a) persons in receipt of flight rewards wholly or partly derived from tax deductible expenditure; and

(b) employers who incur expenditure in such a way that it may allow an employee to access flight rewards.

6. In this Ruling, 'employer' extends to associates of an employer, and 'employee' extends to relatives and associates of an employee.

Ruling

Flight rewards received under a consumer loyalty program

Employer

7. Flight rewards, with one exception, are not subject to FBT as they result from a personal (that is, non-employment) contractual relationship. The exception is where the person with the personal contract is also an employer and provides the flight reward received to an employee in respect of the employment. It should be noted the Commissioner has determined that flight rewards accrued from membership of consumer loyalty programs are distinct and separate from any benefit resulting from the payment by the employer of membership fees.

Employees

8. Flight rewards received by employees from employer-paid expenditure are not assessable income.

Individuals rendering a service or in business

9. Flight rewards that are received by an individual who renders a service or has received the flight reward as a result of business expenditure are, with one exception, not assessable as the flight rewards arise as a result of a personal (that is, non-service/non-business) contractual relationship. The exception is where the person renders a service on the basis that an entitlement to a flight reward will arise (e.g., a person enters into a secretarial service contract with an understanding that a flight reward will be received).

Value of flight rewards

10. In respect of free air tickets and ticket upgrades, the Commissioner accepts a valuation method based on a percentage of the full published fare (referred to in the industry as the full undiscounted fare) for economy, business and first class travel of the relevant airline. The percentages to be adopted for this method are detailed in the following table:

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

11. The above table is to be used as a guide in determining the fair market value. The percentages take into account restrictions applicable to flight rewards in respect of each class of fare and are based on fare information provided by the airline industry. Any other method of valuation that produces a fair market value is accepted by the Commissioner.

12. Where accumulated points are redeemed for an upgrade in the class of travel, the fair market value of the upgrade is the fair market value of the class travelled, determined by reference to the above table, less the amount paid for the lower class of travel.

13. Other flight rewards are to be valued at a fair market value which would usually be the arm's length cost to the general public.

Date of effect

14. This Ruling applies to years commencing both before and after its date of issue. The Ruling does not apply to taxpayers to the extent it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Previous Rulings

15. The four previous Taxation Rulings on this topic (TR 93/2, TR 94/15, TD 95/61 and TD 96/15) will be withdrawn when this Ruling and related Determinations (TD 98/D10, TD 98/D11) issue in final form.

Explanations

16. In *Payne's* case, Mrs Payne joined the consumer loyalty program without her employer's knowledge. Mrs Payne was unable to cash in the flight reward (airline tickets) or transfer it to anyone else, but she was able to have the flight reward made out in the name of family members. The reward points Mrs Payne accrued from employer-paid travel (and some privately-paid travel) were used to acquire airline tickets in the name of her parents who travelled from England to visit her. The Commissioner assessed Mrs Payne on the value of the airline tickets that accrued from employer-paid travel. The Federal Court held Mrs Payne was not assessable in respect of the flight reward as she received the flight reward as a result of the personal contract she established with the airline on payment of the membership fee.

Ordinary income

17. The first consideration is whether the flight reward has the characteristics of ordinary income. The 'Note' in subsection 6-5(1) of the Act requires section 10-5 to be consulted as specific provisions may affect the treatment of some ordinary income. Section 10-5 has a listing for 'non-cash benefits' that directs one to 'benefits' and 'employment'. Under 'benefits' is a listing for 'business, non-cash' that directs one to section 21A of the *Income Tax Assessment Act 1936* ('the 1936 Act'). Under 'employment' is a listing for 'allowances and benefits in relation to employment or rendering services' that directs one to paragraph 26(e) of the 1936 Act.

18. In *Payne's* case, Foster J considered whether the flight reward was income according to ordinary concepts. He determined it was not income based on the reasoning of the Full Federal Court in *FC of T v. Cooke and Sherden* 80 ATC 4140; (1980) 10 ATR 696; (1980) 29 ALR 202. The key findings were the flight reward was not 'money' or 'money's worth' (characteristics listed by Halsbury LC in *Alexander Tennant v. Robert Sinclair Smith (Surveyor of Taxes)* [1892] AC 150 at 157) and the flight reward was not convertible into cash. Hence, for an employee, the flight reward was not income.

19. Section 21A of the 1936 Act requires that 'in determining the income derived by a taxpayer, a non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash'. The issue of whether there is a 'non-cash business benefit' is considered in paragraphs 22 to 25. For a flight reward to be assessable to a business taxpayer, it must have the characteristics of ordinary income with the exception it is not convertible to cash. It is considered highly unlikely a business taxpayer would have a contract that allows for remuneration in the form of a flight reward, but if such a contract existed, the flight reward would be income.

20. In the High Court decisions of *Hayes v. FC of T* (1956) 96 CLR 47; (1956) 11 ATD 68 and *Scott v. FC of T* (1966) 117 CLR 514, the learned justices commented that before an amount can be brought within paragraph 26(e) of the 1936 Act, it must first fall within subsection 25(1) (now section 6-5 of the Act) as ordinary income. Since then, three other learned justices of the High Court have indicated they do not agree with these earlier comments (see Gibbs J in *Reseck v. FC of T* (1975) 133 CLR 45; 75 ATC 4213; (1975) 5 ATR 538, and Toohey and Brennan JJ in *Smith v. FC of T* (1987) 164 CLR 513; 87 ATC 4883; (1987) 19 ATR 274). Dr Paul Gerber, Deputy President of the AAT, stated in *Case Z9* 92 ATC 144 at 152; *AAT Case 7752* (1992) 23 ATR 1057 at 1066:

> 'In summary, I am satisfied in the current state of the law that sec 26(e) is not restricted to bringing to tax receipts which are otherwise income according to ordinary concepts.'

21. It is concluded only a business taxpayer could have a flight reward assessed as ordinary income under section 6-5 of the Act because only a business taxpayer can have a non-cash benefit treated as if it were cash and, hence, be ordinary income. Other taxpayers must be considered under section 6-10 of the Act (statutory income) which directs one to paragraph 26(e) of the 1936 Act. Paragraph 26(e) is discussed in paragraphs 22 to 25.

Employment or business relationship

22. In determining the tax implications of rewards received from consumer loyalty programs, a consideration common to both the income tax and FBT provisions is to identify whether, in the provision of the reward, there exists the necessary employment or business relationship. The relevant provisions of the 1936 Act (*Payne's* case having been considered under the 1936 Act and these also still being the operative provisions) and the FBTAA are:

Business taxpayers:

> '21A(5) [of the 1936 Act] In this section: ...
>
> **"non-cash business benefit"** means property or services provided ...
>
> (a) wholly or partly ***in respect of a business relationship***; or
>
> (b) wholly or partly for or in relation directly or indirectly to a business relationship' (emphasis added)

Employees (where FBT does not apply)*:*

> '26 [of the 1936 Act] ... the assessable income of a taxpayer shall include-...
>
> (e) the value to the taxpayer of all ... benefits ... allowed, given or granted to him ***in respect of***, or for or in relation directly or indirectly to, ***any employment*** of or services rendered by him ...' (emphasis added)

Employers:

> '136(1) [of the FBTAA] In this Act, unless the contrary intention appears: ...
>
> **"fringe benefit"**, in relation to an employee, in relation to the employer of the employee, in relation to a year of tax, means a benefit: ... ***in respect of the employment*** of the employee, ...' (emphasis added).

23. The identification of the relationship, if any, between the giving of the benefit on the one hand and the taxpayer's employment or business activities on the other, is crucial to determining whether the taxpayer receives a benefit in any capacity other than that of employee or business operator and whether it can be said the benefit is in consequence only of the taxpayer's employment or business activity or of some other consideration. Although *Payne's* case dealt purely with an employment situation, it is considered the following comments apply equally in a business context.

24. In *Payne's* case, the matter of identifying whether an employment relationship existed, i.e., whether the provision of the free travel was '***in respect of ... employment***', attracted considerable argument. The Federal Court decided if there was a benefit given, it was given as a result of the personal contract between the taxpayer and the consumer loyalty program provider notwithstanding the benefit arose as a 'consequence' of the employment. The Court found paragraph 26(e) of the 1936 Act did not apply as the points were not earned because of the employment relationship but because of the

relationship between the passenger and the airline, a relationship that was not productive of income for the passenger.

25. The Court further found the flight tickets were provided in 'consequence' of the taxpayer's employment in that the flights that earned the necessary points were undertaken in the course of her employment and paid for by her employer. The employment was, therefore, an indirect or 'contributory cause' of the receipt of the benefit. However, this was not sufficient for the benefit to be taxable under paragraph 26(e) as, per Foster J (FCR at 321; ATC at 4425; ATR at 535), 'for a benefit, etc., to be caught by the section, there needed to be a role played by the employer in the giving, etc., of the benefit'. This is lacking where the employee is the person who makes the decision to join or not join the loyalty program. In *Payne's* case, the taxpayer's employer had no part in the program and did not encourage, arrange or pay for the employee to participate.

Alternative views

26. It has been argued flight rewards received by an employee from employer-paid expenditure are assessable to the employee. This is based on the proposition that the employer is aware the employee can obtain a flight reward from the employer-paid expenditure if the employee is a member of a consumer loyalty program.

27. Support for this view comes from the decision of the Tax Court of Canada in *Mommersteeg et al v. The Queen* 96 DTC 1011, a case that was considered but not followed in *Payne's* case. Foster J found (FCR at 319-320; ATC at 4423-4424; ATR at 534) section 6 of the *Canadian Income Tax Act* relied upon the term 'received or enjoyed' whereas paragraph 26(e) of the 1936 Act (the equivalent Australian provision) relied upon the term 'given or granted' and these terms were clearly distinguishable. The similarities between the consumer loyalty programs and how the flight rewards were acquired in the two cases are so close the difference in tax treatment can only be explained by accepting the term 'received or enjoyed' provides a different outcome from the term 'given or granted'.

28. The Commissioner accepts the term 'given or granted' requires the employer and employee to have an understanding the employee will receive an entitlement to flight rewards from employer-paid expenditure. The fact an employer may have a policy that allows employees to use points acquired from employer-paid expenditure for private purposes is not, of itself, enough to demonstrate an employee will receive flight rewards as it is up to the employee to determine if they will receive flight rewards by becoming a member. Similarly, just because an employer has paid the membership fee for a consumer

loyalty program, does not mean the employee will ever receive flight rewards unless the employer has agreed that sufficient employer-paid expenditure will occur to result in flight rewards. In any event, the flight rewards must be received in respect of employment.

Cross references of provisions

29. Section 6-5 of the Act, to which this Ruling refers, expresses the same ideas as subsection 25(1) of the 1936 Act.

Your comments

30. This draft was previously issued as Taxation Ruling TR 97/D15. Comments received indicated there were further issues to consider. If you wish to comment on this Draft Ruling, please send your comments by: 21 August 1998

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- frequent flyer benefits
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- FBTAA 136(1)
- ITAA97 6-5
- ITAA97 6-5(1)
- ITAA97 6-10
- ITAA97 10-5
- ITAA36 21A
- ITAA36 25(1)
- ITAA36 26(e)

case references
- FC of T v. Cooke and Sherden 80 ATC 4140; (1980) 10 ATR 696; (1980) 29 ALR 202
- Hayes v. FC of T (1956) 96 CLR 47; (1956) 11 ATD 68
- Mommersteeg et al v. The Queen 96 DTC 1011
- Payne v. FC of T (1996) 66 FCR 299; 96 ATC 4407; (1996) 32 ATR 516
- Reseck v. FC of T (1975) 133 CLR 45; 75 ATC 4213; (1975) 5 ATR 538
- Scott v. FC of T (1966) 117 CLR 514
- Smith v. FC of T (1987) 164 CLR 513; 87 ATC 4883; (1987) 19 ATR 274
- Alexander Tennant v. Robert Sinclair Smith (Surveyor of Taxes) [1892] AC 150
- Case Z9 92 ATC 144; AAT Case 7752 (1992) 23 ATR 1057