

Taxation of Loyalty Points under GST

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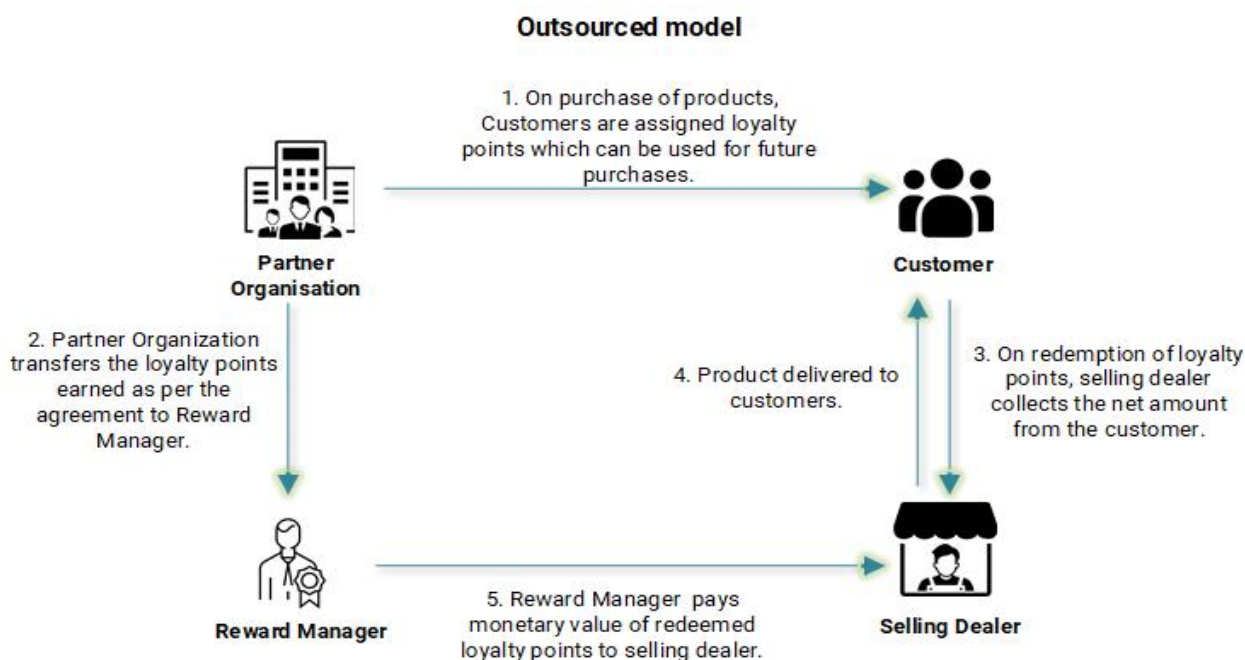


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A) Background

1. Businesses are constantly looking to methods to incentivize customers to buy their products / services. One such method is by issuing loyalty / reward points to the customers on purchase of products / services; points that can be redeemed within a defined, subsequent period. Loyalty points are either internally managed by the business (e-commerce companies issue and manage the points for customers on their platform) or are outsourced to a third party, generally referred to as Reward Manager.
2. Under the internally managed model, an entity that issues loyalty points to customers on purchase of products also administers the issuance and redemption of those loyalty points. Each loyalty point is assigned a monetary value by the issuing entity. The loyalty points can be redeemed during subsequent purchases of goods / services. Loyalty points are different from vouchers. Readers can refer article on [Taxability of Vouchers under GST](#) published in Taxutra on November 03,2023.
3. Under the outsourced model, the Reward Manager administers loyalty points for Partner Organizations (Partner) in terms of an underlying agreement. Generally, the following activities are involved in this scheme of arrangement:
 - a) On purchase of products of Partner, the customers get loyalty points, which [can be redeemed by customers on future purchases. Reward Manager maintains loyalty points so earned.](#)
 - b) Upon the customer getting rewarded with loyalty points, Partner transfers amount equivalent to the loyalty points earned as per the agreement, to Reward Manager.
 - c) On redemption of loyalty points, the net amount (Original cost of this purchase less the monetary value of redeemed loyalty points) is collected from the customer by the selling dealer and product is delivered to the customer. The selling dealer then recovers the monetary value of redeemed loyalty points from Reward Manager. A pictorial diagram of the model is provided:



d) Loyalty points earned by a customer generally have a validity period, say 24 months. Reward Manager is (generally) entitled to retain the amount corresponding to expired points.

e) On this basis, Reward Manager has the following streams of revenue -

- i) Administration Fee (from Partner) for managing the loyalty points; and
- ii) Amount corresponding to expired loyalty points.

B) Relevant references under CGST Act:

Under the Central Goods and Services Tax Act, 2017 (CGST Act),

1. **Goods**^[1] is defined to mean every kind of movable property other than money and securities **but includes actionable claim**, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply.
2. **Actionable claim**^[2] shall have the same meaning as assigned to it in section 3 of the Transfer of Property Act, 1882 (4 of 1882).
3. **Actionable claim**^[3] means a claim to any debt, other than a debt secured by mortgage of immoveable property or by hypothecation or pledge of moveable property, or to any beneficial interest in moveable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognise as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, **conditional** or contingent.
4. Section 7(2) (a), activities or transactions specified in Schedule III shall be treated neither as supply of goods nor a supply of services. Amongst other transactions / activities listed in Schedule III of the CGST Act, 'Actionable claims, other than specified actionable claim' is listed as neither supply of goods nor a supply of services.
5. Specified actionable claim^[4] means the actionable claim involved in or by way of (i) betting; (ii) casinos; (iii) gambling; (iv) horse racing; (v) lottery; or (vi) online money gaming.
6. Loyalty points confer the right to claim the benefit of reward points. On reading the definition of actionable claim it can be fairly concluded that loyalty points would fall within the meaning of actionable claim.
7. Whether the inclusion of actionable claim in the definition of goods as given in Section 2(52) of Central Goods and Services Tax Act, 2017 is unconstitutional or contrary to the legal meaning of goods came up before the Hon'ble Supreme Court in the case of **Skill Lotto Solutions Pvt. Ltd. - W.P. (Civil) No 961 of 2018**. The Hon'ble Apex Court held that the inclusion of actionable claim in definition "goods" as given in Section 2(52) of Central Goods and Services Tax Act, 2017 is not contrary to the legal meaning of goods and is neither illegal nor unconstitutional.

8. Though loyalty points fall within the meaning of actionable claims and goods, the same does not tantamount to 'supply', since 'Actionable Claims', other than specified actionable claim' are treated neither as supply of goods nor supply of services in terms Section 7(2) (a) read with paragraph 6 of Schedule III and Section 2(102A) of the CGST Act. To buttress this argument reference to **Loyalty Solutions and Research Private Limited** [\[TS-312-AAR-2018-NT\]](#) would be of help, wherein the Honorable AAR Haryana has mentioned that reward points earned by the end customers for purchase of products of "partners" to loyalty programme are indeed "actionable claim". In toto, issuance of loyalty points to the customers by the partners would not tantamount to supply.
9. **Redemption of loyalty points by customer:** The customers can redeem the loyalty points earned for purchase of products / or receive services. Upon redemption of loyalty points, the vendor sells the goods / provides the service as the case maybe. Some of the mechanism followed for supply of goods or services upon redemption of loyalty points is discussed hereunder:

Let's consider a situation where a product is sold by dealer partnered with the Reward Manager or under internally managed model for Rs. 1500/- and loyalty points corresponding to Rs. 1000/- are applied thereagainst.

a) If the loyalty points are administered by Reward Manager

Where the selling dealer has issued invoice as under:

| | |
|--|------------|
| Product sale value | Rs. 1500/- |
| Discount | Rs. 1000/- |
| Net sale value - cash paid by customer | Rs. 500/- |
| Processing charges by reward manager | Rs. 99/- |

GST implication on the above transaction would be

- Net sale value -
 - Although the Invoice displays 'Discount' Rs. 1000/-, this amount is received from Reward Manager per agreement previously entered into. GST would be payable by selling dealer on Rs. 1500/-, since consideration^[5] in relation to supply includes any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person.
- Reward Manager would be liable for GST on Processing charges.

b) If the loyalty points are administered by Reward Manager

| | |
|--------------------------------------|-------------|
| Product sale value | Rs. 1,500/- |
| Redemption of points by customer* | Rs. 1,000/- |
| Cash paid by customer | Rs. 500/- |
| Processing charges by reward manager | Rs. 99/- |

* Rewards manager pays to the vendor Rs. 1,000/-.

- Product Sale - The selling dealer in the illustration is required to pay GST on Rs. 1,500/. Though the consideration of Rs. 1,000/- is not paid by the customer, GST would be payable on Rs. 1,000/- also, since in terms of Section 2 (31) (a) of the CGST Act, 2017 the consideration for supply of goods or services or both includes payment made by the recipient or by any other person.
- Processing charges levied by the reward manager will be liable to applicable GST.

c) If the loyalty points are internally managed

| | |
|--|--------------------------------|
| Product sale value | Rs. 1500/- |
| Discount | Rs. 1000/- |
| Net sale value - cash paid by customer | Rs. 500/- |
| Processing charges | Nil (since internally managed) |

- Consideration received of Rs.500/- only for the product sold and no other consideration flows. GST would be payable on Rs.500/-.

10. Expiry of loyalty points

The tax implication on expired loyalty points has been a contentious issue under the erstwhile service tax provisions and continues even under the GST law. Loyalty points earned by the customers on purchase of products of partners which expire after the validity period can no longer be used by the customers and the customer loses right over the Loyalty points upon its expiry. Even after expiry, loyalty points do not lose the character of actionable claim, since loyalty points are 'conditional' which would fall within Section 3 of the Transfer of Property Act, 1882. As such, the expired points would not be liable to tax under GST law as the same would be covered in Schedule III of the CGST Act, 2017. Further, in the paper writer's view, despite the Advance Ruling cited below, while expired loyalty points result in revenue for Reward Manager, they do partake the color of supply. In this regard, a high/er court decision would be illuminating.

However, in the case of **Loyalty Solutions and Research Private Limited** Advance Ruling No. HAR/HAAR/R/2017/18/4 dated 11.04.2018, the Honorable Authority for Advance Ruling, Haryana has held that 'The value of points forfeited of the applicant on which money has been paid by the issuer of points on account of failure of the end customers to redeem the payback points within their validity period **is to be treated as "supply" of services and consequently be chargeable to GST under the CGST, HGST or IGST Act as the case may be**'. The said Ruling has been upheld by the Honorable Appellate Authority for Advance, Haryana.

11. **Service charges for managing reward points** - Reward Manager generally charges a fee separately for managing the reward points of the partner/s and the said fee is liable to tax as a service under GST law.

[1] Section 2(52) of the CGST Act

[2] Section 2(1) of the CGST Act

[3] Section 3 of the Transfer of Property Act, 1882

[4] Section 2 (102A) of the CGST Act

[5] Section 2(31) of CGST Act