Missing the point? Financial & tax considerations of loyalty point redemptions

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Canadians love collecting points. A 2018 CIBC Poll[1] found that over half (52%) of Canadian credit card holders earn points towards travel, merchandise or other rewards. Surprisingly, 82% of them don't think about their points as a financial asset and 1 in 5 (20%) of those who use a rewards card for their everyday purchases don't know how many points they've accumulated.

While reward points may have originated with the airline industry, today nearly every retailer, from the grocery store, to the gas station and coffee shop, has their own loyalty rewards program. Some credit cards also provide these programs, giving consumers the ability to collect points even faster. In fact, according to a 2018 study, Canadian consumers belong to an average of 12.2 loyalty programs and are active in 7.3 programs.[2]

While it's fun to collect points, it's also important to remember that these loyalty points are an asset that can be redeemed for merchandise, travel (flights and hotels), and even experiences. Yet, while most (71%) reward cardholders believe "points are as good as cash," the CIBC poll found that 73% don't check or compare the retail cost of purchasing an item or trip before redeeming points.

Here are some things to bear in mind before redeeming for those rewards.

First, you should consider whether it is a good financial decision to redeem points for the particular reward. To do so, you compare the cost to purchase the item against the points required to be redeemed. For example, if you could use 100 points to obtain item A, which sells for $100, or item B, which sells for $125, item B would be the better choice, assuming that you actually "need" both items. Comparing cost to points can sometimes be trickier than it first looks, especially with air travel, where you may need to pay various taxes and fees for your "free" ticket.[3]

In addition, in some cases, there may be personal tax considerations to be included in the decision-making process and this report will review a number of these.

A taxable benefit?

The first consideration is whether points you receive and then redeem could give rise to any personal tax benefit to you.

Personal use

Where loyalty points or airlines miles are awarded to you in the course of your personal expenditures or personal travel, there are no tax consequences to you when you earn them (it's like getting a discount on future spending / travel) nor when you redeem them.

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[1] 2018 CIBC Reward Points Poll (June 2018).

[2] Statista 2018: Loyalty program enrollment per program member in Canada 2014-2017, by type: statista.com/statistics/545966/number-loyalty-programs-per-prorgam-member-canada-type/.

[3] Some programs allow you to apply points to pay taxes and fees on your free ticket so you may wish to check the terms of your program when looking at the value of the points redemption reward.

Business use

But what if you earn points either through business travel or through collecting points on a credit card used for business expenses?

Employees

Let's say you're an employee who earns loyalty points for expenses that are paid by your employer, either directly or through reimbursement. For instance, you may collect frequent flyer miles when you travel for business. You may also be awarded loyalty points when paying for business use items with your personal credit card for which you are then reimbursed, such as business lunches or hotels while on a business trip.

A number of years ago, the Canada Revenue Agency ("CRA") took the position that in these circumstances if your employer does not control the points accumulated, it is up to you to determine the fair market value of the free trip, or merchandise received, and include that amount in your income for the year that you enjoyed the trip or received the merchandise.

Practically speaking, this has always been a challenge for employees for two reasons. First, what is the fair market value of that flight to Las Vegas? (See "What is fair market value of an airline ticket?" below.) More significantly, was that free vacation attributable to points earned while flying on employer business or to points earned on personal spending charged to that same credit card? If points are commingled, which points are deemed to be used first: the taxable employer-earned points or the non-taxable personally-earned points?

Fortunately, in recent years, the CRA changed its view. The current position is that the employee only needs to include a taxable benefit in income if either the points are converted to cash, the plan is considered to be an alternate form of remuneration or the plan is for tax-avoidance purposes. In these cases, the taxable benefit is equal to the fair market value of the personal rewards received in the year. If the employer controls the points, then this benefit must be reported on a T4 information slip. This could occur, for example, where the points are earned on a corporate credit card.[4] Here's a few examples.

Example 1

Bill's employer permits him to pay for his work-related expenses using his personal credit card, on which loyalty points are awarded for purchases. Bill redeems some points for a family vacation.

Bill will not be required to include any amount in income relating to the redemption of points, as "this arrangement does not seem to be a form of additional remuneration."[5]

Example 2

Roberta's employer also permits her to pay for business expenses using her personal credit card. To maximize points earned, Roberta uses her personal credit card to pay for travel expenses of other employees.

The CRA would treat this situation as a form of additional remuneration. The CRA's view is that Roberta "would not normally pay for employer business costs other than her own work-related expenses. She would not normally cover the cost of business expenses of other employees."[6]

Roberta will be required to include in her income the fair market value of any rewards redeemed with points arising from business use of her credit card. Her employer, however, would not be responsible for reporting any taxable benefits associated with redemption awards as Roberta, and not her employer, controls the points.

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[4] canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/benefits-allowances/gifts-awards-social-events/gifts-awards-outside-policy.html#lyltyprgms.

[5] Ibid.

[6] Ibid.

Example 3

Steve has the use of a company credit card on which loyalty points are awarded for purchases. He uses the card to pay for business expenses. His employer receives and pays the credit card bills and receives the statement tracking loyalty points. Steve is permitted to redeem points earned for his personal use.

Steve's employer will be required to report a taxable benefit on Steve's T4 for the fair market value of any rewards redeemed in the year of redemption. This occurs because the employer "controls the tracking and redemption of points."[7] What that fair market value, is, however, is another question – see "What is fair market value of an airline ticket?" below.

Business owners

Using business points for personal rewards/travel

A business owner may redeem points collected using a corporate credit card for a personal reward, such as airline tickets for a family vacation. The same principles set out above should apply in determining whether you the business owner received a taxable benefit.[8]

Using personal points for business expenses/travel

Business owners sometimes pay for business-related expenses using points that were accumulated on purchases made for personal use ("personal points.") For instance, you may choose to redeem personal points for an airline ticket for a business trip. Can you be reimbursed for this by your corporation and if so, how should this amount be calculated?

If the business travel ticket was acquired purely through the redemption of personal points, you can be reimbursed by your corporation for a reasonable amount equal to the fair market value of the ticket. This reimbursement should be deductible by your corporation.

It gets more complicated, however, if you have comingled the collection of loyalty points through business purchases ("business points") and personal points. The CRA's general assumption is that the business points are used first. For example, suppose you have collected enough business points to cover the amount required for a ticket. If the corporation pays you an amount that exceeds the taxes or fees incurred to actually redeem the travel miles, the excess must be included in your income as a taxable benefit. If the business points are insufficient to cover the full cost of the ticket, you may be entitled to a reimbursement from your corporation for a portion of the travel miles used.

What is fair market value of an airline ticket?

The CRA generally takes the position that the fair market value of a reward airline ticket is the price that you would have had to pay for a comparable ticket entitling you to travel on the same flight in the same class and subject to the same restrictions applicable to the reward ticket. Obviously, you would deduct from this fair market value any amount you must pay for the ticket in the form of taxes or fees.

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[7] Ibid.

[8] This assumes that the benefit of the use of the loyalty points was the result of being an employee of the corporation. If it is instead determined that the benefit was received in your capacity as a shareholder of the corporation, then it will be taxable to you as a shareholder benefit, which may have punitive tax consequences. The CRA has not issued substantive guidance on when a shareholder benefit will arise in the context of loyalty points.

What else can you do with points?

Pay down debt or invest

Another financial perk that may come as a surprise to many cardholders is that you may be able to use loyalty points to either reduce debt, such as a mortgage, line of credit or credit card debt, or purchase an investment. Depending on the financial institution, the investment may also be permitted in a registered plan such as a Tax Free Savings Account (TFSA), Registered Retirement Savings Plan (RRSP) or even a Registered Education Savings Plan (RESP), which can lead to additional tax benefits. In the case of RESPs, there may also be government grants such as the 20% matching Canada Education Savings Grant.

When deciding whether to use your points to pay down debt or invest, allocate the points in the same way as if you were using cash to pay down debt or invest.

You should take into account whether the interest on the debt is deductible for tax purposes. Consider whether you can get a higher after-tax rate of return on your investments than the after-tax interest rate on your debt, given a level of risk at which you are comfortable. If so, then investing is generally the better bet; otherwise, paying down debt is the better choice. For further information, please see our report Mortgages or Margaritas: Is paying down debt putting your retirement at risk?[9]

Claim a medical expense tax credit for travel with points

If you need to travel beyond 40 kilometres to obtain medical treatment because it is not provided where you live, you can claim the cost of transportation as a medical expense for purposes of the medical expense tax credit ("METC"). [10]

What if instead of actually paying for transportation by cash or credit, you redeem points or miles to "purchase" that trip? In at least one tax court case[11], it was held that the value of the points that were "cashed in" was indeed eligible for the METC where travel was necessary for medical treatment. The taxpayer was permitted to claim the cost of an equivalent ticket.[12]

Donate your points

Some charities now accept the donation of loyalty points, yet the CIBC poll found that almost a third (29%) of reward cardholders aren't aware of this reward option. The CRA's general view is that a donation tax credit can be claimed when loyalty points are used to make a gift, provided that they can be transferred to the charity and their value can be reasonably estimated. The amount of the donation tax credit that may be claimed is based on the fair market value of the points when the transfer occurs.

Alternatively, you may donate an airline ticket or other merchandise acquired through the redemption of points. In these circumstances, you will be entitled to a donation tax credit based on the fair market value of the airline ticket or merchandise.

Conclusion

There are various ways to both accumulate points and to redeem them. When doing so, be mindful of both the dollar value that you're getting by redeeming points and the tax consequences, if any, of the redemption. The good news is that in most cases, those points can indeed be redeemed tax-free! And, if you use your points to pay down debt, save for retirement or for kids' post-secondary education, you might be able to benefit from even more money in your pocket if there are additional tax savings and government benefits related to the reward.

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[9] The report *Mortgages or Margaritas: Is paying down debt putting your retirement at risk?* Is available online at cibc.com/content/dam/personal_banking/advice_centre/retirement/mortgages-or-margaritas-en.pdf.

[10] Valid medical expenses qualify for a 15% federal credit as well as a provincial/territorial credit, provided they exceed a minimum threshold equal to the lesser of 3% of your net income or $2,479 federally (for 2022, indexed annually.)

[11] *Johnson v. The Queen*, 2010 TCC 321.

[12] Since this case was heard under the Tax Court's "informal procedure" (the equivalent of small claims court for tax matters), the decision, while influential, is not legally binding on future judges.

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