

BUSINESS INSURANCE: UNDERSTANDING THE TAX IMPLICATIONS



Understanding the tax implications of business assurance is an important element of the advice giving process.

With this marketing document we aim to make it easy for financial planners to understand the relevant legislation and its business assurance application. On the right is a table mapping the specific tax legislation applicable to the various business assurance needs:



Applicable legislation per need	Income Tax	Estate Duty		Capital Gains Tax
	Section 11(w)	Section 3(3)(a)(ii)	Section 3(3)(a)(iA)	Paragraphs 55(1)(b), (c) and (e) of the Eighth Schedule**
Contingent Liability*	✓	✓		✓
Credit Loan Account*	✓	✓		✓
Buy and Sell			✓	✓
Key Person*	✓	✓		✓
Debit Loan Account				✓
Overhead Protection*	✓	✓		✓
Replacement of Income				✓

* Company-owned Policy

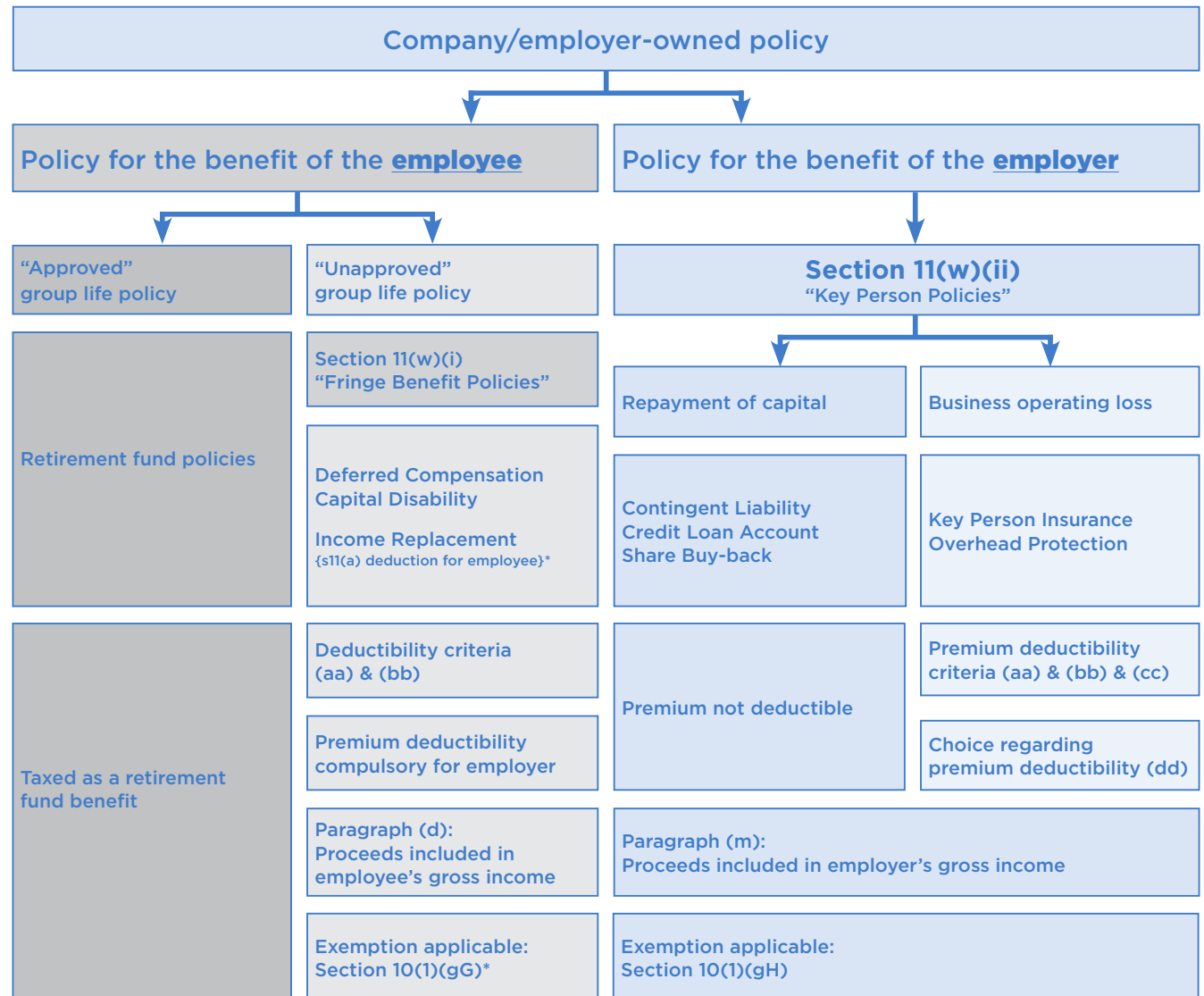
** Plans ceded to the respective lives insured will not become second-hand plans, by virtue of the exemption as per paragraph 55(1)(c) of the Eighth Schedule to the Income Tax Act. A pure risk plan (with no cash or surrender value) will also not become a second-hand plan if ceded outright to anyone (paragraph 55(1)(e) of the Eighth Schedule to the Income Tax Act).

Section 11(w) of the Income Tax Act – Summary

Section 11(w) of the Income Tax Act is only applicable to company/ employer-owned policies.

These are policies that could be for the benefit of the company/employer or the employee, or for both.

Section 11(w) governs the rules with regard to the deductibility of the premiums and can be summarised as follows:



Section 11(a) deduction for employer is applicable to “employment event” policies only.

Section 11(w) - Technical Summary

Section 11(w)(i) "Fringe Benefit Policy"	Section 11(w)(ii) "Key Person Policy"
PREMIUM DEDUCTIBILITY CRITERIA	
<p>(aa) The policy relates to the death, disablement or severe illness of an employee/a director of the tax payer, and</p> <p>(bb) The premium paid by the company/employer is deemed to be a taxable benefit granted to the employee/director in terms of paragraph 2(k) of the Seventh Schedule.</p>	<p>(aa) Insured against any loss due to death, disability, severe illness, on life of director/employee and</p> <p>(bb) Pure risk policy with no cash/surrender value and</p> <p>(cc) Employer-owned when the premium is paid (security cession does not change ownership status)</p> <p>If all the requirements above are met, then the tax payer has a choice, under (dd), regarding the deductibility status of the premium.</p> <p>(dd) In respect of a policy entered into:</p> <p>(A) on or after 1 March 2012, the policy agreement states that this paragraph applies in respect of premiums payable under the policy, or</p> <p>(B) before 1 March 2012, it is stated in an addendum to the policy agreement by no later than 31 August 2012 that this paragraph applies in respect of premiums payable under the policy.</p>
<p>Note: There is no choice with regard to the deduction of the premium for the company/employer. If the premium is included in the taxable income of the employee, the taxpayer (company/employer) must claim the deduction or else it will be lost.</p>	
<p>Company/employer-owned income replacement policies (unapproved group life fund) – the employee can deduct premiums in terms of section 11(a), as premiums are deemed to be paid by the employee. Any benefit paid to the employee does not qualify for the exemption under section 10(1)(gG)*</p>	

EXEMPTION CRITERIA	
Section 10(1)(gG)	Section 10(1)(gH)
<p>(i) In the case of a policy that is a risk policy with no cash value or surrender value, if the amount of premiums paid in respect of that policy by the employer of the person has been deemed to be a taxable benefit of the person in terms of the Seventh Schedule since the later of: (aa) the date on which the company/employer contemplated in those subparagraphs became the policyholder of the policy or (bb) 1 March 2012, unless premiums paid were deductible by the person in terms of section 11(a).</p> <p>(ii) In the case of any other policy, if an amount equal to the aggregate of the amount of any premiums has been included in the income of the person as a taxable benefit in terms of the Seventh Schedule since the date on which the policy was entered into.</p>	<p>(i) The policy relates to death, disablement or severe illness of an employee/a director or a former employee/director of the person that is the policyholder, and</p> <p>(ii) No amount of the premiums payable in respect of that policy on or after 1 March 2012 is deductible from the income of that person for the purposes of determining the taxable income derived by the person from carrying on any trade.</p>

* Section 11(a) deduction for employer applicable to "employment event" policies only.

Section 3(3)(a) of the Estate Duty Act

"The General Rule"

A life assurance policy on the life of a person is deemed to be property in their estate in the event of their death. The policy is therefore dutiable.

1

There are two exceptions to "The General Rule"

Public Benefit Organisation (PBO)

Section 4(h) deduction

Surviving spouse

Section 4(q) deduction

2

Must be a "Domestic Policy"

... "so much of any amount due and recoverable under any policy of insurance which is a 'domestic policy' upon the life of the deceased"

Domestic policy... is a policy that is issued anywhere but is made payable in South Africa. It includes whole life, endowment, term, group life and personal accident policies.

3

The full proceeds of the policy are, however, not always dutiable

"Where the policy proceeds are not recoverable by the estate of the deceased, but by another person and this other person also paid premiums in respect of the policy, then only so much of the proceeds as exceeds the premiums paid by the other person plus 6% compound interest is deemed to be property."

4

AN EXAMPLE

Company A owns a policy on the life of an employee, John. The company has paid the premiums of R10 000 p.a. for a period of five years, after which John died.

The policy proceeds of R150 000 are paid directly to the company. The policy is dutiable (not exempt). The amount that is deemed to be property in John's estate is determined as follows:

THE CALCULATION

N	=	5
I/Yr	=	6
Pmt	=	10 000
FV	=	59 753

Begin mode

Amount recoverable:	R150 000
Less: Premiums paid plus 6% p.a.:	R59 753
Amount deemed to be property:	R90 247

5

Section 3(3)(a)(ii) of the Estate Duty Act – Summary

Section 3(3)(a)(ii) of the Estate Duty Act is applicable to company/ employer-owned policies only. These are policies that could be for the benefit of the company/employer or the employee, or for both. Section 3(3)(a)(ii) contains the rules that govern the estate duty exemption that could apply to the proceeds of policy and can be summarised as follows:



Estate Duty Exemption applicable to Company-owned Policies

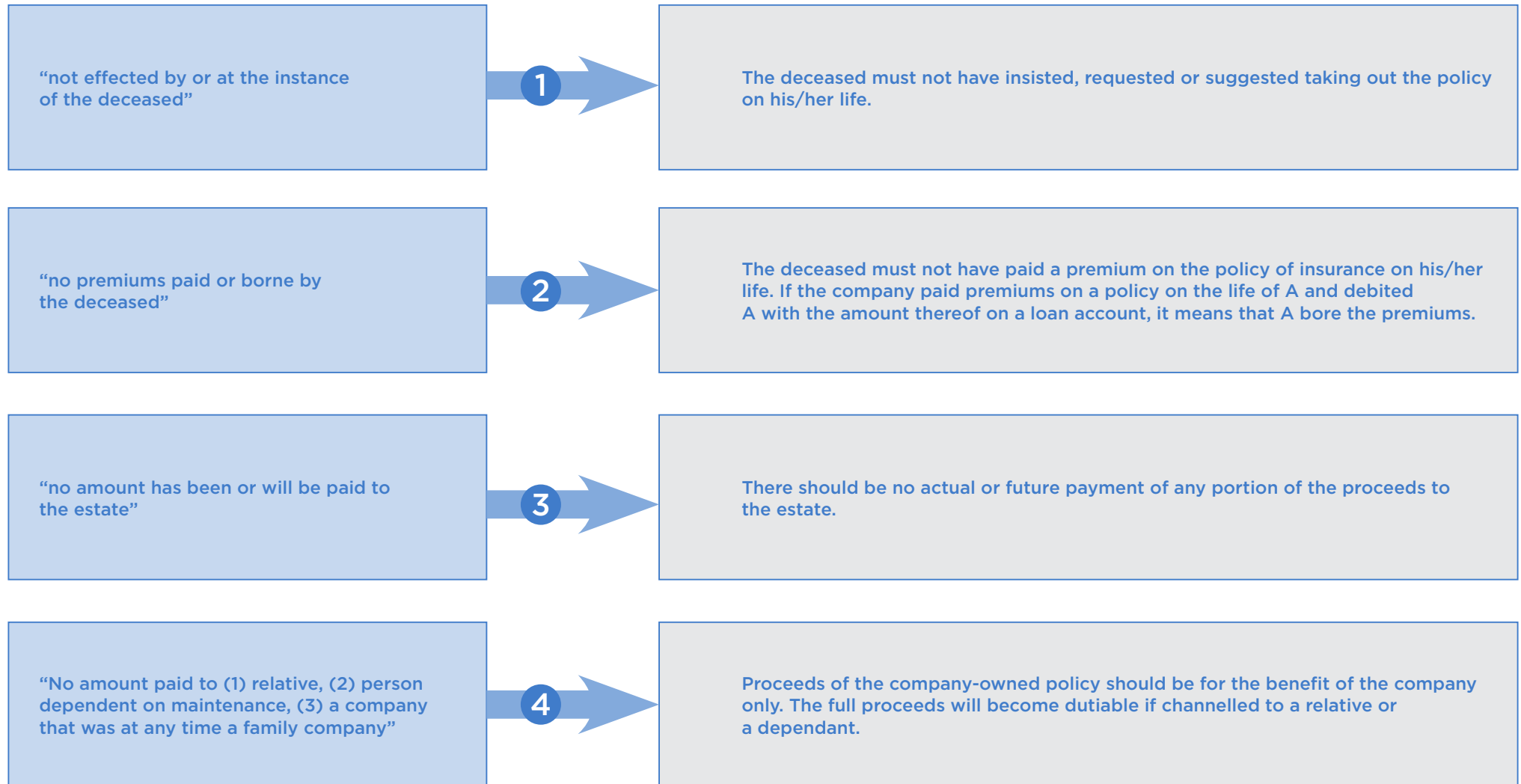
- 1 The policy was not effected by or at the instance of the deceased.
- 2 No premium on the policy was paid or borne by the deceased.
- 3 No amount due or recoverable under the policy has been or will be paid into the estate of the deceased.
- 4 No amount has been or will be paid to, or utilised for the benefit of any relative of the deceased or any person wholly or partly dependent for his/her maintenance upon the deceased or any company that was at any time a family company of the deceased.

NB: NO PRO RATA BENEFIT ENVISAGED BY THE ACT.

The Commissioner must be “satisfied” that all the requirements of the section have been met before the exclusion will be allowed. The following supporting documents can be submitted to the Master’s Office together with the Liquidation and Distribution Account:

- “Copy of resolution from company to take out such a policy” (should not be signed by the insured)
- “Application made for the policy”
- “Documentation proving proceeds did not go to estate, relative, maintenance of dependant or proving it is not a family company”

Section 3(3)(a)(ii) of the Estate Duty Act – Interpreting the requirements



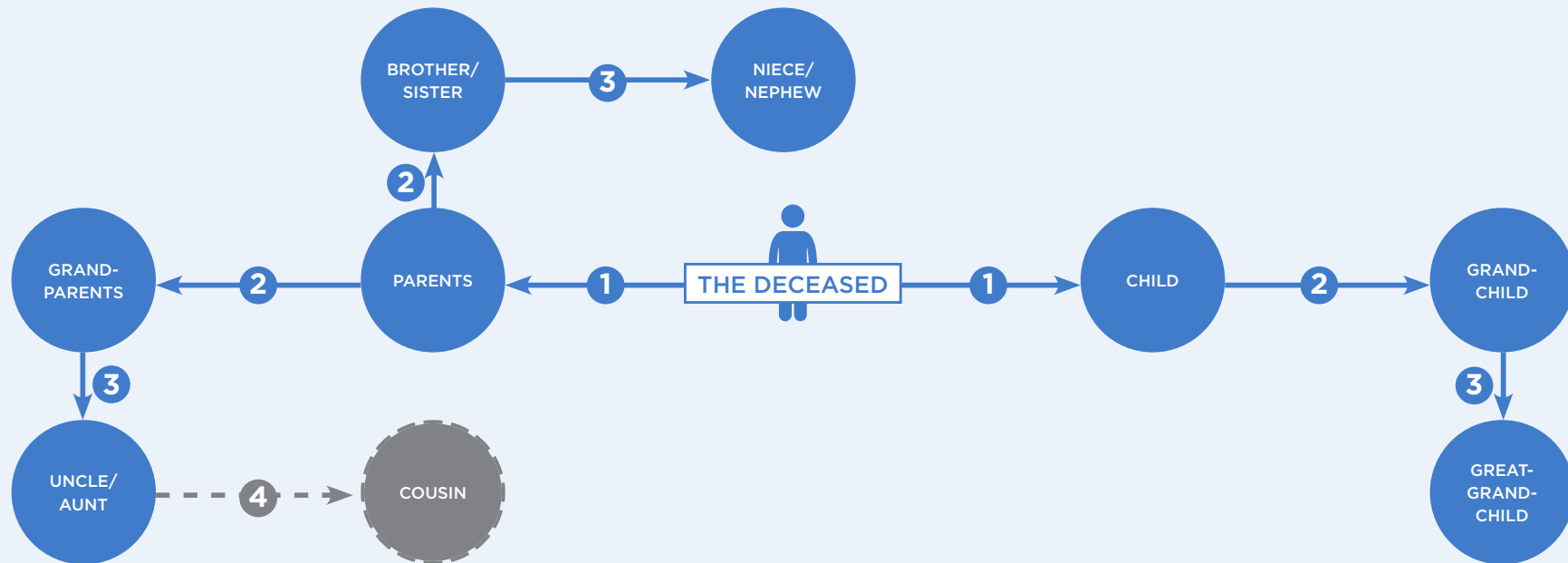
If any of the above requirements are not adhered to the estate duty exemption falls away.

Family Company: Definition (section 1 of the Estate Duty Act)

- Any company (other than a listed company)
- Which at any relevant time was controlled, or capable of being controlled, directly or indirectly:
 - Through majority shares or
 - Any other interest or
 - In any manner whatsoever by the deceased or
 - By the deceased and one or more of his/her relatives



Relative in relation to the deceased person - within the third degree of consanguinity (relation)



1. Spouses included.

2. Child shall be deemed to be related to its adoptive parent in the first degree on consanguinity.

Section 3(3)(a)(iA) of the Estate Duty Act – Summary

Section 3(3)(a)(iA) of the Estate Duty Act is applicable to buy and sell arrangements only.

These are policies where owners of a business obligate themselves at death (or permanent disability) to buy and sell each other's interests in their business. Section 3(3)(a)(iA) contains the rules that govern the estate duty exemption that could apply to the proceeds of these policies and can be summarised as follows:

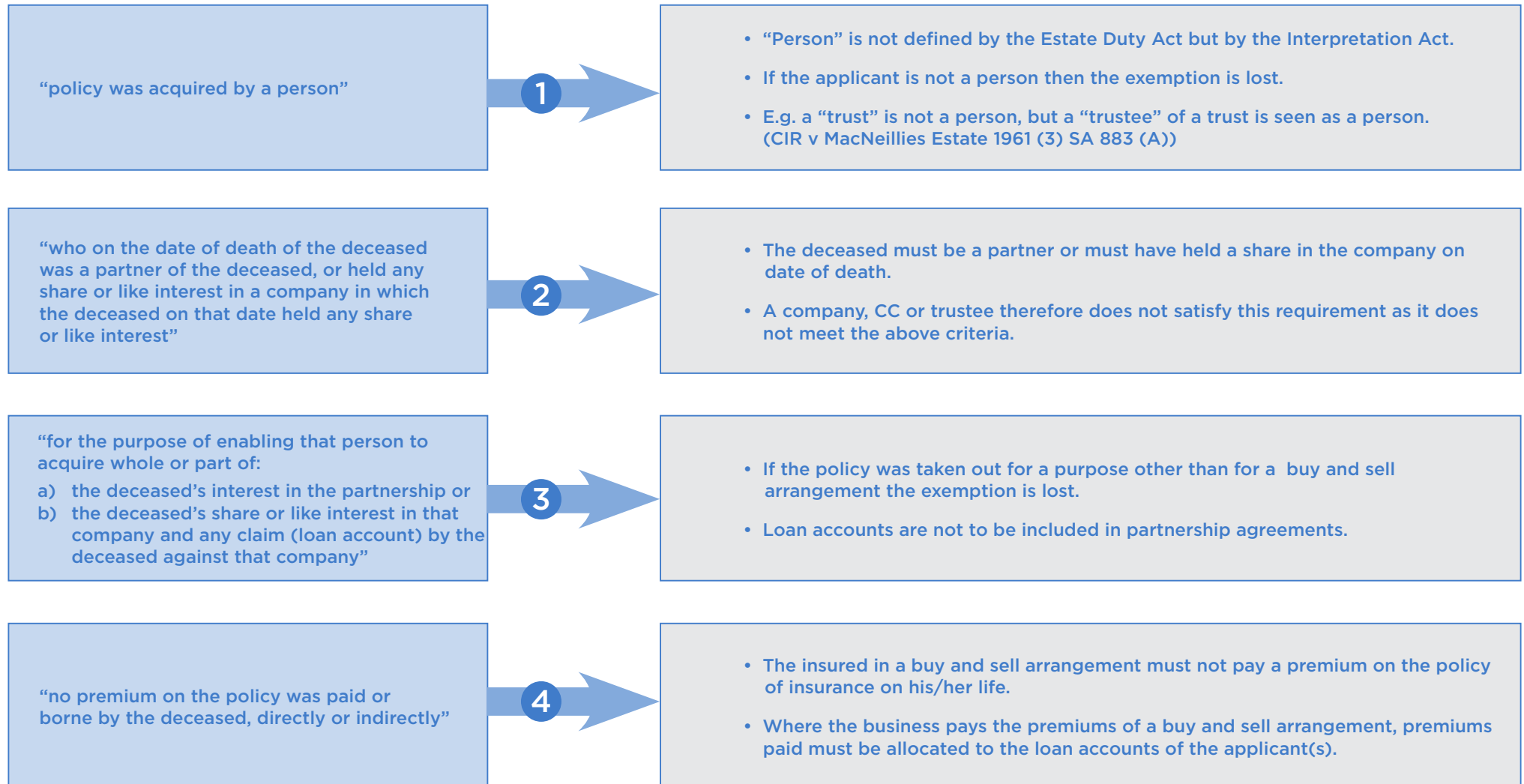


Estate Duty Exemption applicable to Buy and Sell Arrangements

- 1 The policy was acquired by a person
- 2 Who, on the date of death of the deceased, was a partner of the deceased, or held any share or like interest in a company in which the deceased on that date held any share or like interest,
for the purpose of enabling that person to acquire the whole or part of:
 - a) the deceased's interest in the partnership concerned or
 - b) the deceased's share or like interest in that company and any claim (loans account) by the deceased against that company.
- 4 No premium on the policy was paid or borne by the deceased.

The Commissioner must be "satisfied" that all the requirements of the section have been met before the exclusion will be allowed.

Section 3(3)(a)(iA) of the Estate Duty Act – Interpreting the requirements



If any of the above requirements are not adhered to the estate duty exemption falls away.