



# DAVEY'S Locker



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## Key-man policy conundrums

### Nonconforming policies

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Amendments (better described as a deletion and substitution) contained in the Taxation Laws Amendment Act, 2010 to s 11(w) dramatically curtailed the tax deduction of premiums paid by an employer under a life insurance policy.

In essence, unless the benefit payable under the policy—which must be for the benefit of the employer only (a 'key-man policy')—arises solely by reason of death, disablement or severe illness of an employee or director (or in qualifying commercial circumstances, such as the use of insurance as debt collateral), the tax deduction will no longer be available, with effect as from 1 January 2011 (92 TSH 2010).

These amendments have created an unintended consequence, in that all employer-owned life policies (other than deferred-compensation-funding policies) now automatically qualify for a tax deduction of premiums under s 11(w).

In other words, there is now no distinction between s 11(w)-conforming policies (premiums deductible and policy proceeds included in gross income) and nonconforming policies (premiums not deductible but policy proceeds tax free). This situation

arises because the amended s 11(w) no longer distinguishes between the criteria required (previously referred to as the 'State President's regulations') for s 11(w) conforming and nonconforming policies.

The practical tax dilemma which thus arises is that nonconforming policy proceeds will also be included in the employer's gross income and hence be taxable with retroactive effect, even though there were no premium deductions allowed under s 11(w).

I understand that ASISA is liaising with the Treasury to retroactively amend s 11(w) so as to cater for this unintended consequence.

As an interim precaution, some life assurance companies are adding a nominal amount of pure investment value to such existing nonconforming policies, which I consider an effective band-aid solution, since it can then be argued that the policy is not only providing life and disability cover but an investment element, thereby disqualifying it from the amended s 11(w) deduction and the consequential inclusion in gross income.

