



DAVEY'S Locker



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Key-man policy conundrums revisited

Further proposed amendments in the draft Taxation Amendment Bill

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BPR 038

In 97 *TSH* 2011, I promised, in 'Offshore insurance policy wrappers', that this month I would examine in detail the new Binding Private Ruling replacing BPR 038. To date this has not been officially published by SARS, and thus my promise must remain in abeyance.

The current topic

I consider myself fortunate to have read for an HDip Tax in the 1980s, since tax life was simpler then. Despite past pronouncements in Budget speeches that the Income Tax Act is to be rewritten and simplified, each annual amendment act appears further to complicate matters.

For example, in the early 1980s a tax deduction could be claimed on an employer-owned policy on the life of an employee, irrespective of the life cover/investment component mix of the policy.

Courtesy of the complaints of other savings industry competitors, the first wave of tax amendments required that a life policy contain a minimum amount of life cover in order to qualify for a s 11(w) tax deduction. Hence the advent of so-called conforming (to s 11(w)) and nonconforming policies.

Further complexities arose by way of cross-reference to the notorious Sixth Schedule to the

cct, aptly described by the authoritative tax reference textbook authors of the day, namely, Silke, Divaris & Stein, as the most complex piece of tax legislation ever enacted. Fortunately this schedule has disappeared, together with the many tax jobs then on offer by the life assurers.

The second wave of amendments were enacted last year, creating consternation, since there were unintended, adverse tax consequences for some employer-owned policies (94 *TSH* 2011).

Fortunately, sense has prevailed, and the third wave of tax amendments should provide both simplicity and certainty to the tax treatment of all life policies, especially employer-owned policies.

In essence, the tax principles effective in the 2012 tax year are as follows:

- If premiums were funded with post-tax contributions, policy proceeds will be tax-free; or
- If the premiums were funded with pre-tax contributions, policy proceeds will be taxable.

(Capital gains tax will still impact upon owners of second-hand long-term insurance policies.)

Examples

- An individual policyholder cannot claim a deduction of

- premiums paid on a life insurance policy. Therefore the proceeds from these life policies will be tax-exempt.
- Under an individual income-protection policy the premiums paid by the individual are deductible. Therefore the proceeds will be taxable.
 - Under an employer group income-protection policy the employer deducts the premiums and the employee initially has matching fringe-benefit income. The employee will enjoy a simultaneous deduction for the premiums (thereby neutralizing the tax as a fringe benefit). As a result, the policy proceeds will be taxable when paid to the employee.
 - An employer will receive a deduction for premiums contributed on an unapproved group life policy. The employee will be deemed to receive matching fringe-benefit income of the premiums.
- Therefore the proceeds will be tax-exempt.
- The impact of policy proceeds under key-person plans is dependant upon the employer's election, which will be made on the policy application form for new policies entered into on or after 1 January 2012. A policy addendum will be required for existing policies elected to be conforming to s 11(w). The default position is that a policy is deemed to be non-conforming, (premiums not deductible, proceeds tax free). Thus, in summary, the employer decides upfront whether the premiums will rank for a deduction under a key-person policy. The proceeds will be taxable if the employer chooses in favour of a deduction, or exempt if the employer chooses otherwise.

