



DAVEY'S Locker



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The Mark Twain principle of taxation

by Tony Davey

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Mark Twain observed in his autobiography that a man with one foot in a bucket of ice and the other foot in a bucket of boiling water would on average feel pretty good. This principle of average, pertaining to long-term insurers, is enacted in s 29A of the Income Tax Act. An insurer pays tax on revenue and capital gains on behalf of policyholders. Upon the maturity or surrender of the policy, the proceeds are supposedly paid out 'tax free' to the policyholder, yet they represent the insurer's after-tax position.

The rate of tax applied to the insurer's natural-person policyholder fund is 30%, which to arithmetically minded observers is somewhere near average natural-person tax rates, which range from 18% to 40%. (In similar vein, the insurer's effective capital gains tax rate is now 10%, while the natural-person effective rates range from 6% to 13,3%.)

This arrangement allows for classic tax arbitrage, since the insurer's rate is substituted for that of the actual policyholder, with the result that natural persons suffering more than a 30% personal income tax rate are scoring, while those in the 18% to 30% brackets are the unwitting losers. The same logic applies to capital gains.

I thus welcome the announcement in the *2012 Budget Review* that the principles of the taxation of insurers are under review.

The short and simple solution is to apply a look-through approach, as is done with a collective investment scheme product (unit trust), and assess the revenue and capital gains in the policyholder's hands.

To be fair, though, if, say, an insurance endowment policy is taxed on the same basis as other competing investment products, the initial minimum five-year lock-in period contained in regulations to the Long-Term Insurance Act should be abandoned, so as to allow the same flexibility enjoyed by unit trusts.

Such flexibility is in fact in line with one of the recommendations of the 'Treating Customers Fairly' initial document recently published by the Financial Services Board.

ADR accolade

Despite criticism that principles of natural justice are flouted, in that the facilitators in ADR proceedings are SARS personnel, my recent experience was of a professional, unbiased approach, and a genuine desire to settle, thus avoiding protracted and costly litigation.

