3 November 2016

<u>Comment from the SAM Tax Task Group on the October 2016 Taxation Laws Amendment Bill ("Oct 2016 TLAB") – in respect of section 29A of the Income Tax Act ("ITA").</u>

1. Introduction

During a meeting on 1 November 2016 attended by various insurers and facilitated by the Financial Services Board ("FSB"), it was proposed that industry provide comments on the October 2016 TLAB to National Treasury ("NT") and the South African Revenue Services ("SARS") relating to the proposed amendments to section 29A of the ITA ("29A amendments"). This is to ensure clarity on the interpretation and application of the 29A amendments and to highlight potential risks.

2. Intended impact of changes on insurers:

Based on the industry's interpretation of the 29A amendments, the following impact is expected on insurers depending on their disclosure applied for IFRS purposes:

- Where an insurer **previously zeroised** negative liabilities for tax purposes and not for IFRS purposes, the move to adjusted IFRS, as defined in the October 2016 TLAB, will result in either a tax neutral position, or an acceleration of tax through the phase-in period depending on whether the insurer discloses negative liabilities on the asset side or the liability side of the balance sheet.

- Where an insurer **previously recognised** negative liabilities for tax purposes but not for IFRS purposed, the move to adjusted IFRS, as defined in the October 2016 TLAB, will result in either a tax neutral position, or a postponement of tax through the phase-in period.

If the industry's interpretation is indeed correct, the aforementioned is contrary to the principles agreed in the meeting between NT and industry representatives on 1 September 2016.

3. Potential impact of the section 29A amendments:

We wish to highlight that the current wording of the 29A amendments would align all insurers with the IFRS treatment of negative liabilities if an insurer **changes its accounting disclosure** in 2016 or any later year (provided that it complies with the IFRS requirements) in a manner that is not consistent with what was done previously for tax purposes. (The current wording in paragraph 16 allows for this benefit to be obtained by any insurer in any future year through a change in its disclosure of negative liabilities for IFRS purposes). This would allow an insurer to increase its value of liabilities and therefore reducing the transfers to the corporate fund.

NT should appreciate the consequences of the alignment to the consistent IFRS treatment of negative liabilities and must take note that insurers who have not zeriorised negative liabilities for tax purposes historically will have the opportunity to do so in accordance with the current section 29A amendments in the relevant year of assessment ending on or after the Insurance Act becomes effective. It should also be noted that there is a minority view within the Task Group that supports the TLAB wording as currently drafted.

This has been demonstrated by way of two sets of examples attached.

a) Examples prepared by tax consultants:

- Specifically refer to the outcome of example 1(b) compared to example 1(c) and 1(a).

The example demonstrates that, following a change in IFRS disclosure, the insurer could potentially defer tax payments by receiving both a deduction from assets as well as an increase in the value of liabilities from the phase-in provisions. This emanates from an inconsistency between the limitations applied to subsection 15 and 16 as proposed in the 29A amendments.

b) Example prepared by insurer:

- Specifically refer to the outcome of scenario B, example 4.

The same inconsistency between subsection 15 and 16 is highlighted as stated in par 3(a) above.

4. Proposed remedy

Assuming that the inconsistency between subsection 15 and 16 in the 29A amendments is considered not to be aligned to NT intention, the proposed remedy would be to revert to the wording suggested by the industry on 5 September 2016 as copied herein:

(15) (a) and (b) ". . . reduced by negative liabilities ~~recognised~~ excluded as an asset in terms of section 29A(16)(1)(a). . ."

(16) (1) For purposes of this section an asset, in respect of a policyholder fund and a risk policy fund, excludes-
(a) negative liabilities;
(b) policies of reinsurance;
(c) a deferred tax asset; ~~or~~ and
(d) goodwill,
recognised as an asset in accordance with IFRS as annually reported by the insurer to shareholders in the audited financial statements: Provided that

(i) the basis of determining the asset in terms of paragraph (1)(a) is consistent with the principles and manner of determining the policy liabilities of the insurer for IFRS purposes; and
(ii) the elimination of the asset so determined is consistent with the approach adopted in determining the value of liabilities for tax purposes

in the year of assessment immediately preceding the year when this subsection becomes effective.

This proviso will only be applicable for years of assessment ending on or before the date that IFRS 17 for Insurance Contracts becomes effective.

The suggested wording aims to treat insurers equally based on their historical tax treatment and does not prejudice insurers based on a particular IFRS treatment. It reinforces the principle that

the negative liability was determined and accounted for consistently for IFRS purposes irrespective of the fact whether it was netted off against policyholder liabilities or disclosed separately as an asset.

By adopting the wording proposed above NT will maintain the tax landscape that was adopted by insurers prior to the effective date of the 29A amendments and it will prevent insurers from using changes in accounting disclosure to reduce their tax base after the 29A amendments become effective.

5. Request for clarity and further engagement

Due to the complexity of these matters we implore that any further changes to the proposed amendments to section 29A, which may be considered by NT, are discussed with the industry prior to promulgation.