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Impact of IFRS 17 Insurance Contracts on the taxation of short and long-term insurers – Taxation Laws Amendment Bill, 2022

IFRS 17 Insurance Contracts (**IFRS 17**) is the new accounting standard that changes the way insurance contracts are accounted for. This new standard replaces the interim standard IFRS 4 Insurance Contracts (**IFRS 4**). IFRS 17 will be effective for reporting periods commencing on or after 1 January 2023. The standard specifically sets out the principles of recognition, measurement, presentation and disclosure of insurance contracts. IFRS 17 aims to improve the consistent application of these principles, enabling users of financial statements to meaningfully compare financial results of insurers.

The implementation of IFRS 17 may have a material impact on the liquidity of some insurers. During the consultation process between National Treasury and the insurance industry, it was established that the implementation of IFRS 17 may result in an increase in the taxable income of both short and long-term insurers. We summarise below some of the relevant amendments relating to IFRS 17 included in the Taxation Laws Amendment Bill, 2022 (**TLAB**).

Impact on short-term insurers

Under the Solvency Assessment and Management framework, short-term insurers may claim deductions for amounts recognised as liabilities in accordance with International Financial Reporting Standards (**IFRS**). In determining the taxable income of a short-term insurer, IFRS insurance liabilities, adjusted for reinsurance assets, deferred acquisition costs and deferred revenue relating to premiums and claims, may be claimed as a tax deduction. This deduction must be added back to taxable income of the short-term insurer in the following year of assessment.

IFRS 17 requires that:

- Estimates of future cash flows included in the determination of insurance contract liabilities is to be discounted to a present value taking time value of money into account;

- Salvages and third-party recoveries are to be included in the determination of the total insurance contract liabilities; and
- Premium debtor amounts are to be included in the determination of the total insurance contract liabilities.

The requirements noted above is anticipated to result in an increase in the taxable income of short-term insurers due to a reduction in the amount that is deductible by the short-term insurer after the implementation of IFRS 17. In order to mitigate the tax and cash flow impact for short-term insurers, the following transitional measures have been proposed:

- A "phasing-in" period of three years is provided to short-term insurers to account for the possible reduction in the deduction which the short-term insurer may claim in determining its taxable income;
- The "phasing-in amount" will be the difference between:
  - The amount that is deductible from the income of a short-term insurer in terms of the current provisions (at the end of the year of assessment commencing on or after 1 January 2022 but before 1 January 2023 determined under the current rules of the Act) and;
  - The amount of the deduction applying the revised provisions in terms of section 28 due to the implementation of IFRS 17 for the period referred to above.

Impact on long-term insurers

Changes will be required to section 29A of the Income Tax Act in order to align the legislation with terminology referred to in IFRS 17. In order to mitigate the tax impact as a result of the difference between the methodologies underlying IFRS 4 and IFRS 17, it is proposed that the following changes be made to section 29A of the Income Tax Act:

Definition of "value of liabilities"

The definition of "value of liabilities" will be amended to refer to all *other* liabilities that fall outside of the "adjusted IFRS value" definition (see revisions to this definition below), but are allocated to policyholder business.

Definition of "adjusted IFRS value"

The implementation of IFRS 17 introduces a distinction in the accounting recognition and disclosure between insurance contract liabilities (in terms of IFRS 17) and investment contract liabilities in terms of IFRS 9. It is proposed that changes be made to refer to "investment contract liabilities" instead of the current general reference to liabilities. "L" in the definition of "adjusted IFRS value" will be amended to replace the term "recoverable under policies of insurance" with "insurance contract liabilities". In addition, the term "negative liabilities" will be amended and be replaced with the term "investment contract liabilities".

Under IFRS 4, liability for incurred claims was allowed to be accounted for as a current liability. Consequently, liability for incurred claims did not form part of the "adjusted IFRS value" definition but was rather included as part of "value of liabilities" definition. Under IFRS 17, subsequent to initial recognition, the liability of a group of insurance contracts comprises the liability for remaining coverage and the liability for incurred claims. It is thus proposed that the definition of "adjusted IFRS value" be amended so that the liability for incurred claims be deducted from the amount of the liabilities in the definition of "adjusted IFRS value" in order to prevent the liability for incurred claims from being included in the zeroisation calculation.

As a result, "L" in the definition of "adjusted IFRS value" will be amended to refer to the aggregate amounts of:

— the net of insurance contract liabilities and investment contract liabilities less corresponding insurance and investment contract assets; and
— the net of reinsurance contract liabilities less corresponding reinsurance contract assets.

Phasing-in measures

The draft tax amendments proposes the following phasing-in measures:

— A phasing-in period of six years that will provide for the phasing in amount to be allowed as a deduction from (or included in) the income of the corporate fund;
— The "phasing-in amount" will be the difference between:
  — The "adjusted IFRS value" amount determined with reference to IFRS 4 (at the end of the year of assessment commencing on or after 1 January 2022 but before 1 January 2023); and
  — The "adjusted IFRS value" determined with reference to IFRS 17 (as amended by this TLAB, and applied to the year of assessment as referred to above.)
— The amount that has been deducted as a "phasing-in amount" will be included in the income of the corporate fund in the following year of assessment (or *vice versa*.)

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Kind Regards

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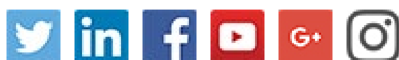

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