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Income tax amendments for non-life insurers

What has happened historically

In the last decade, two significant changes were introduced to the tax legislation for non-life insurance companies:

- **The first was introduced in the 2012 taxation laws amendments which removed the discretion that was held by SARS to make adjustments to the regulatory reserve amounts applied for tax purposes.**
- **The second change was introduced in the 2015 taxation laws amendments in response to the Prudential Authority's implementation of the Solvency Assessment and Management (SAM) framework. Under this amendment SARS required non-life insurance companies to deduct amounts recognised as insurance contract liabilities, in line with those amounts recognised for accounting purposes under *IFRS 4 Insurance Contracts* (IFRS 4).**

Time for change

Following the release of *IFRS 17 Insurance Contracts* (IFRS 17), effective for year ends beginning on or after 1 January 2023, amendments to section 28 of the Income Tax Act (the Act) were enacted in the 2022 Taxation Laws Amendment Act. These amendments are applicable for years of assessment commencing on or after 1 January 2023 and mitigate potential unfavourable tax impacts emanating from the accounting changes as a result of insurers moving from IFRS 4 to IFRS 17. Set out below are the primary reasons for the tax changes:

- Under IFRS 4, salvages and recoveries were not recognised as part of insurance contract liabilities and accordingly was not taxed on the accrual basis, but rather on the receipt basis. With the recent amendment under IFRS 17, salvages and recoveries will be included as part of insurance contract liabilities and will be fully taxable when accrued under the new legislation in the year of transition.
- The recognition and measurement requirements set out under IFRS 17 require certain asset amounts to be offset against insurance contract liabilities relating to the liability for remaining coverage (LRC), for example premium debtors and the deferred acquisition costs asset. Under IFRS 4 these asset balances were presented gross of the insurance contract liability balances.
- The terminology applied in section 28 of the Act will be amended to align with that of IFRS 17.

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- In the year of transition to IFRS 17, the use of IFRS 17-determined insurance contract liabilities in the tax computation may have resulted in higher amounts being taxed or lower amounts being deducted than should have been applied, when compared to the IFRS 4-determined insurance contract liabilities applied in previous years.

To counter against the challenges noted above, section 28 provides relief to mitigate the income tax implications emanating from the different methodologies applied between IFRS 4 and IFRS 17. The relief provided is as follows:

Once-off adjustment

Section 28(3C) of the Act allows non-life insurance companies to make a once-off adjustment to their taxable income in the first year of assessment commencing on or after 1 January 2023 as follows:

- Include amounts recoverable on claims incurred at the end of the last year of assessment, on or after 1 January 2022 but before 1 January 2023, which have not been received by the end of that year of assessment;
- Deduct the LRC at the end of the last year of assessment, on or after 1 January 2022 but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment; and
- Deduct the net amounts of insurance premium or reinsurance premium debtors and reinsurance payables taken into account in determining the LRC as at the end of the last year of assessment, on or after 1 January 2022 but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment.

Introduction of the phasing-in amount

Section 28(3D) introduces the concept of a ‘phasing-in’ amount which is to be applied over a period of three years commencing from 1 January 2023. This provision was introduced to address the deduction related to the increase in tax liabilities post the implementation of IFRS 17.

The deduction available under the ‘phasing in amount’ is calculated as the difference between:

a) The amount deductible for tax purposes under section 28(3) in respect of insurance contract liabilities for the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023; and

b) the amount deductible for tax purposes under section 28(3) in respect of insurance contract liabilities for the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023 had IFRS 17 and the amended section 28(3) been applied at the end of the last year of assessment.

The amount calculated above is reduced for the difference between:

- insurance premium debtors and reinsurance premium debtors; and
- reinsurance premium payable at the end of the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023 had IFRS 17 been applied, other than amounts forming part of the LIC.

The phasing-in amount is thereafter increased by the amount recoverable on claims incurred at the end of the last year of assessment on or after 1 January 2022 but before 1 January 2023 which have not been received by the end of that year of assessment.

In instances where the amount calculated under b) is greater than that calculated under a), the phasing-in amount results in an increase to taxable income as opposed to a deduction.

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Recurring deduction in respect of the LIC

Section 28(3) has been amended to incorporate the changes in terminology to align with IFRS 17. It follows that non-life insurers are now able to claim a deduction for liabilities for incurred claims net of amounts related to reinsurance contracts as determined under IFRS 17.

Looking ahead

Reflecting on the changes set out above, the adjustments to be made in the first year of assessment commencing on or after 1 January 2023 are technical and will require careful consideration by management and the board of directors. The accounting in terms of IFRS 17 will need to be understood and will have a significant impact on the tax adjustments to be made.

There may be queries expected from SARS to understand how the once-off adjustment and phasing in amount is determined, due to their technical nature.

Financial managers and tax accountants are encouraged to closely monitor the various accounting adjustments and understand these in light of the income tax amendments in a timely manner. The time and effort involved in achieving the end goal cannot be underestimated.