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Connecting *IFRS 17 Insurance Contracts* (IFRS 17) and tax legislation

The implementation of IFRS 17 and the various resulting changes to tax legislation resulted in numerous challenges experienced throughout the insurance industry over the last few months.

The recent amendments to section 28 of the Income Tax Act No. 58 of 1962 (the Act), as amended by the 2022, 2023 and 2024 Taxation Laws Amendment Acts, resulted in concerns within the non-life insurance industry. Section 28 of the Act addresses specific provisions relating to non-life insurance companies. Following the implementation of IFRS 17, the amended section 28 of the Act is applicable for years of assessment commencing on or after 1 January 2023. Industry concerns have arisen in respect of the tax treatment of certain amounts included in the once-off adjustments for the liability for remaining coverage (LRC), in terms of section 28(3C) of the Act, and the phasing-in amount, in terms of section 28(3D) of the Act.

For ease of reference, we will refer to the year ended prior to the effective date of IFRS 17 implementation, i.e. years of assessment commencing on or after 1 January 2022 but before 1 January 2023, as the transition year, and the year in which IFRS 17 is applied as the effective year.

Section 28(3C) addresses the tax treatment of the once-off adjustment non-life insurers should apply in the first year of assessment commencing on or after 1 January 2023.

The once-off adjustment is to be calculated as follows:

- add to taxable income amounts recoverable on claims incurred at the end of the transition year, which have not been received by the end of that year of assessment;
- deduct from taxable income the LRC at the end of the transition year had IFRS 17 been applied at the end of that year of assessment; and
- deduct from taxable income the net amounts of insurance and reinsurance premium debtors and reinsurance payables taken into account in determining the LRC as at the end of the transition year had IFRS 17 been applied at the end of that year of assessment.

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 provide relief to insurance taxpayers and spread either the additional tax liability or tax deduction a taxpayer may be liable for or entitled to post the implementation of IFRS 17.

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 (this will be the transition year *IFRS 4 Insurance Contacts* (IFRS 4) balances); and

b. the amount deductible for tax purposes under section 28(3) in respect of insurance contract liabilities for the transition year of assessment had IFRS 17 and the amended section 28(3) been applied at the end of the last year of assessment.

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The amount calculated above is reduced for the difference between:

- the net amount of insurance and reinsurance premium debtors had IFRS 17 always been applied; and
- reinsurance premium payable at the end of the transition year of assessment had IFRS 17 always been applied;

other than amounts forming part of the liability for incurred claims (LIC).

The phasing-in amount is thereafter increased by the amount recoverable on claims incurred at the end of the transition year, which have not been received by the end of that year of assessment.

Our recent experience has highlighted several challenges and areas of uncertainty identified by non-life insurers, in the application of these amendments to the Act:

1. Salvages and recoveries

Prior to the amendments to section 28 of the Act, amounts relating to salvages and recoveries were required to be taxed only when the amounts were received by the insurer.

The amendments to section 28(3C) of the Act require non-life insurers to make a once-off adjustment to taxable income in the effective year by taxing salvages and recoveries that were not received at the end of the transition year.

While the application of section 28(3C) of the Act is a once-off adjustment to the taxable income of an insurer in the year of IFRS 17 implementation, insurers should carefully consider the impact when submitting the income tax return for the transition year.

Historically, some non-life insurers adopted a conservative approach and included in their tax the asset on salvages and recoveries each year as it was accrued, and not when these amounts were received. Consequently, for these insurers, since these amounts were already taxed during the transition year, applying the amendment to section 28(3C) will amount to an insurer being taxed twice on the same amount. This outcome is not considered to be aligned with the intention of the legislation.

To counter this unintended consequence, one option available to taxpayers would be to consider a re-submission of the transition year tax return.

Another option would be for these insurers to submit comments to National Treasury highlighting the anomaly and requesting relief, clarity or a potential update to the current legislative provisions. This may also be dealt with as a collective where National Treasury could be approached through industry representation bodies, such as the South African Insurance Association (SAIA).

2. Phasing-in amount

The ‘phasing-in amount’ calculated in terms of section 28(3D) is determined as either an initial additional tax or an initial tax deduction over a three-year period. It is important that this amount is appropriately determined in the year of IFRS 17 implementation, as well as assessed for continued appropriateness post implementation, as this calculation impacts financial and tax reporting for three financial periods.

To put it more simplistically, the phasing-in amount is the difference between the technical insurance liabilities calculated under IFRS 4 and the LIC calculated in terms of IFRS 17 at the end of the transition year. This amount is then adjusted for insurance and reinsurance premium debtors and reinsurance premiums payable **other than** amounts forming part of the LIC.

By deduction, this would imply that the difference between the IFRS 4 insurance technical liabilities and the IFRS 17 LIC amount should be adjusted by the insurance and reinsurance premium debtors and reinsurance premium payables **which are part of the LRC**.

However, section 28(3C) requires a once-off deduction of the LRC and includes an adjustment to reduce the LRC by the insurance and reinsurance premium debtors and reinsurance premium payables forming part of the LRC.

Reflecting on the requirements of section 28(3C) and 28(3D) of the Act, it appears that the same amounts require adjustment in respect of insurance and reinsurance premium debtors and reinsurance premium payables under both provisions, resulting in a potential double deduction that might materialise.

The intention of the legislation is to analyse the amounts specifically attributable to technical insurance liabilities, whilst simultaneously avoiding the duplication of adjustments. Based on our interpretation of the Act, it would be most appropriate to adjust for insurance and reinsurance premium debtors and reinsurance premium payables that are part of the LIC under section 28(3D).

3. Insurance related debtor and creditor balances

IFRS 17 requires insurance related debtor and creditor balances to be classified as part of the LIC or LRC. Under IFRS 4, these balances would have been presented separately from the insurance technical balances, typically as part of trade and other receivables or trade and other payables.

The application of the transitional provisions set out in sections 28(3C) and 28(3D) of the Act raises a concern in that assets or liabilities now classified as part technical insurance liabilities under IFRS 17 may potentially be taxed or deducted twice. To elaborate, the insurance related debtor or creditor balance may have already been taxed or deducted in the transition year, with the risk that the same amounts are taxed or deducted in the effective year as part of the application of the transition provisions.

While the Act does not contain any provisions which preclude an amount from being taxed twice, section 23B of the Act probits an amount from being deducted twice. We recommend that non-life insurers carefully examine the adjustments made as part of the application of transition provisions. Further, as it relates to there being no provisions in the Act which preclude an amount from being taxed twice, non-life insurers may consider making a submission to National Treasury highlighting the anomaly created by the transitional provisions.

Conclusion

The transition to IFRS 17 was an immensely complex exercise, equally so for accounting and tax practitioner. Instances of inadvertently ending up in a double taxation or double deduction scenario are plentiful. We encourage insurers to apply careful consideration in the determination of their taxable income, particularly as it relates to the tax return submission process currently underway for many non-life insurers. The legislative landscape is continuously evolving with not all the answers yet available in response to areas of challenge – insurers should continue to closely monitor this space and lobby for clarity through industry bodies or individual interactions with tax authorities.