SARS South African Revenue Service

BINDING GENERAL RULING (INCOME TAX): NO. 30

DATE: 7 January 2016

ACT : INCOME TAX ACT NO. 58 OF 1962

SECTION : SECTION 29A

SUBJECT : ALLOCATION OF DIRECT AND INDIRECT EXPENSES WITHIN AND BETWEEN AN INSURER'S FUNDS

Preamble

For the purposes of this ruling –

- **"BGR"** means a binding general ruling issued under section 89 of the Tax Administration Act No. 28 of 2011;
- **"insurer"** means any **"**long-term insurer**"** as defined in section 1 of the Long-term Insurance Act No. 52 of 1998;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This BGR determines –

- the allocation of direct and indirect operating expenses within and between the funds that are required to be established by insurers under section 29A and the subsequent deductibility of such operating expenses, and
- the deductibility of expenses against transfers under section 29A(7).

2. Background

2.1 Establishment of the funds

The taxable income derived by any insurer in respect of any year of assessment must be determined in accordance with the Act, but subject to sections 29A and 29B.[1]

Every insurer is required to establish five[2] separate funds and to maintain such funds.[3] These funds form the foundation for the operation of section 29A as a whole. The taxable income derived by an insurer in respect of the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund[4] must be determined separately in accordance with the Act as if each such fund had

1 Section 29A(2).

2 The requirement of five funds instead of four funds is effective from 1 January 2016.

3 Section 29A(3).

4 Effective from 1 January 2016.

been a separate taxpayer.[5] The income received by or accrued to an insurer from assets held by it in, and business conducted by it in relation to, the untaxed policyholder fund is exempt from tax.[6]

An insurer is required to re-determine the value of liabilities in each policyholder fund and the risk policy fund within three[7] months after the end of every year of assessment. Where the market value of the assets in the fund exceeds the value of liabilities, assets with a market value equal to the excess must be transferred from such fund to the corporate fund. Where the market value of the assets is, however, less than the value of liabilities, assets with a market value equal to the shortfall must be transferred from the corporate fund to the relevant fund.[8] These transfers are viewed as notional adjustments relevant only for purposes of calculating the insurer's annual tax liability and do not affect the insurer's legal ownership of the assets concerned.

2.2 Allocation of expenses

Section 29A(12) stipulates that in the allocation of any expense to any of the funds an insurer must –

- to the extent to which the expense relates exclusively to business conducted by it in any one fund allocate that expense to that fund; and
- to the extent to which that expense does not relate exclusively to business conducted in any one fund, allocate that expense in a manner which is consistent with and appropriate to the manner in which its business is conducted.

Expenses which an insurer considers to be incurred to produce the excess assets to be transferred from a policyholder fund or the risk policy fund to the corporate fund and the associated costs attributed to it are to be allocated to such policyholder fund or risk policy fund. The transfer to the corporate fund is essentially a net profit that is derived by deducting all relevant expenses in the policyholder fund and the risk policy fund first.

Expenses allocated to the corporate fund are not regarded to be incurred with a view to obtain the transfer from the policyholder fund or the risk policy fund as the corporate fund will not incur any expense to produce these transfers. Expenses allocated to the corporate fund relate to shareholder activities only.

Expenses that do not relate exclusively to business conducted in any one fund and which have not been classified as direct policyholder expenses, for example, operational overhead costs, general marketing costs, directors' fees, audit fees,[9] are inconsistently treated by insurers in calculating the taxable income of the different funds. The fact that "the manner in which its business is conducted" referred to in section 29A(12) is not defined in the Act further contributes to the inconsistent treatment of these indirect operating expenses.

5 Section 29A(10).
6 Section 29A(9).
7 Section 29A(7) stipulates four months. With effect from 1 January 2016 the requirement is three months.
8 Section 29A(7).
9 This is not an exhaustive list of possible expenses.

2.3 Determination of taxable income

Specific rules are set for the determination of the taxable income of the individual policyholder fund, the company policyholder fund, the risk policy fund and the corporate fund.[10] The expenses and allowances allowed as a deduction in the policyholder funds are limited to the total of –

(a) the amount of expenses and allowances directly attributable to the income of such fund ("direct expenses"); and

(b) a percentage of the amount of –

   (i) all expenses allocated to the fund which are directly incurred during such year of assessment in respect of the selling and administration of policies; and

   (ii) all expenses and allowances allocated to such fund which are not included in (a) above ("indirect expenses"), but excluding any expenses directly attributable to any amounts received or accrued which do not constitute "income" as defined in section 1(1).

The amount referred to in (b) above is determined in accordance with the formula set out in section 29A(11)(*a*)(ii).

The rules for the deduction of expenses by an insurer referred to in section 29A(11)(*a*) do not apply to the corporate fund. The expenses in the corporate fund are subject to the requirements of section 11 read with section 23.

The determination whether expenses are directly attributable to the income of a policyholder fund or risk policy fund, or directly attributable to amounts which do not constitute income of such a fund, also referred to as direct expenses, is a matter of fact. A direct causal link is required between income earned and the expense incurred to earn the income.

Certain expenses, such as asset management fees, can be attributed to multiple income streams within a specific fund. Other expenses may relate to a class of assets as opposed to a particular income stream. In these instances it becomes difficult to link a particular expense to a specific fund.

3. Ruling

In view of the inconsistent treatment of expenses within and between the separate funds of an insurer, the treatment of expenses set out below is accepted for purposes of section 29A(11) and 29A(12):

(a) Direct expenses must be allocated to the policyholder funds and the risk policy fund in a manner consistent with the way in which the insurer does business.

(b) Direct expenses relating to shareholder activities only must be allocated to the corporate fund.

(c) Indirect operating expenses incurred to produce the excess assets to be transferred from the policyholder fund or the risk policy fund to the corporate fund and the associated costs attributable to it are to be allocated to such policyholder fund or risk policy fund.

[10] Section 29A(11).

(d) To the extent that indirect operating expenses cannot be allocated to any fund in particular–

(i) an apportionment of the expense must be made between the corporate fund and the other funds in aggregate, using the average value of liabilities for the policyholder funds and the risk policy fund and the average market value of assets for the corporate fund at the commencement and end of the year of assessment;

(ii) once expenses have been allocated to the different funds a further apportionment between the individual policyholder fund, company policyholder fund, the untaxed policyholder fund and the risk policy fund must be made using the gross premiums received by the respective funds;

(iii) the apportioned indirect operating expenses allocated to each policyholder fund are subject to the expense ratio contemplated in section 29A(11) for the individual policyholder fund and the company policyholder fund;

(iv) the apportioned indirect operating expenses allocated to the corporate fund and the risk policy fund should further be apportioned with reference to the ratio of income[11] in the fund concerned plus the taxable capital gain applicable to the fund concerned over total amounts received or accrued (irrespective of whether these amounts are of a capital or revenue nature), provided that transfers from the policyholder funds at the end of the year of assessment are excluded in this calculation from both the income and the total amounts received or accrued.

Expenses directly attributable to income[12] in the individual policyholder fund and the company policyholder fund are deductible under section 29A(11)(*a*)(i). Expenses directly attributable to exempt income in the untaxed policyholder fund are not deductible.

Expenses directly attributable to assets that give rise to income[13] in the individual policyholder fund and the company policyholder fund may be claimed under section 29A(11)(*a*)(i) to the extent they are not of a capital nature. Expenses that are directly attributable to assets that give rise to exempt income will not be deductible. Indirect operating expenses that cannot be directly attributed to assets within a specific policyholder fund and allocated to the particular fund as directed above must be treated as indirect expenses and claimed under section 29A(*a*)(ii).

The deduction of expenses allocated to the corporate fund and the risk policy fund is subject to the requirements of section 11 read with section 23. No expenses relating to the corporate fund activities are allowed to be deducted in the corporate fund from the transfers contemplated in section 29A(7) since no expense is viewed to be incurred in the corporate fund to produce such transfer.

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act No. 28 of 2011 insofar as it relates to the tax treatment of expenses incurred by an insurer.

---

[11] See definition in section 1(1).
[12] See definition in section 1(1).
[13] See definition in section 1(1).

4. Period for which this ruling is valid

This BGR applies from date of issue until it is withdrawn, amended or the relevant legislation is amended.

Senior Manager: Corporate Income Tax
Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE