

VAT PRACTICE NOTE NO 1 of 2001

31 July 2001

Treatment of Insurance Indemnity Payments

1. This practice note is issued in order to clarify any uncertainties regarding the meaning of the provisos to section 8(8) of the Value-Added Tax Act, 1991.
2. Section 8(8) of the Act provides that:

"(8) For the purposes of this Act, except section 16(3), where a vendor receives any indemnity payment under a contract or is indemnified under a contract of insurance by the payment of an amount of money to another person, that payment or indemnification, as the case may be, shall, to the extent that it relates to a loss incurred in the course of carrying on an enterprise, be deemed to be consideration received for a supply of services performed on the day of receipt of that payment or on the date of payment to such other person, as the case may be, by that vendor in the course or furtherance of his enterprise: Provided that this subsection shall not apply in respect of any indemnity payment received or indemnification under a contract of insurance where the supply of services contemplated by the contract is not a supply subject to tax under section 7(1)(a): Provided further that this subsection shall not apply in respect of any indemnity payment received by a vendor under a contract of insurance to the extent that such payment relates to the total reinstatement of goods, stolen or damaged beyond economic repair, in respect of the acquisition of which by the vendor a deduction of input tax under section 16(3) was denied in terms of section 17(2) or would have been denied if these sections had been applicable prior to the commencement date." (My emphasis.)

3. Proviso 1

Section 7 of the Act is the section in terms of which value-added tax is levied and paragraph (a) of subsection (1) specifically levies VAT in respect of the supply of goods and services by a vendor in the course or furtherance of his enterprise. Even though VAT may, in terms of section 11 of the Act be levied at the rate of zero per cent, it does not alter the fact that VAT is in the first instance levied in terms of section 7(1) of the Act. Section 11 of the Act merely serves to alter the rate of tax from the standard rate, which is currently 14 per cent, to the rate of zero per cent, but the supply nevertheless remains a taxable supply.

Premiums on short-term policies are payments for services supplied and are, in terms of section 7(1)(a) of the Act, subject to VAT at the standard rate if the insurer is a vendor. However, section 11(2) of the Act provides that where VAT is chargeable under section 7(1) it will in certain cases be charged at the rate of zero per cent, e.g. where the insured vendor pays short-term insurance premiums to the insurer who is also a vendor for insuring the transport of passengers or goods to or from an export country (see section 11(2)(d) of the Act). Even though the premium for the insurance of passengers or goods is zero rated, the indemnity payment/claim is standard rated. Section 8(8) of the Act deems the claim to be a consideration received by the insured for a supply of services.

4. It follows that, where an insurer who is registered as a vendor under the Act, provides insurance to another vendor, any indemnity payment to the insured or any other person, excluding those catered for in proviso 2, whereby the insured is indemnified by the insurer, will attract VAT in the hands of the insured to the extent that it relates to a loss incurred by the insured in the course of carrying on his enterprise. This is so, irrespective of the fact that the service of providing insurance may have been supplied at the rate of zero per cent, e.g. as contemplated in section 11(2)(d) of the Act.
5. Proviso 2

Where the supply of services contemplated by the insurance contract is not subject to tax under section 7(1)(a) of the Act, for example, where an overseas insurance company which is not registered as a vendor makes an indemnity payment, the provisions of section 8(8) of the Act do not apply. The implication of this is that input tax is not claimable in respect of premiums and indemnity payments are not subject to output tax in terms of section 8(8) of the Act.

In respect of an indemnity payment received by a vendor on insured goods on which an input tax deduction was denied in terms of section 17(2) of the Act, no output tax is payable.

6. All previous rulings issued by the Commissioner for SARS or any official under his control relating to the first proviso to section 8(8) of the Act, where the premium (or part thereof) was subject to VAT at the zero rate, is hereby withdrawn with immediate effect.

AML/PRAK1

Withdrawn