



# be informed

Legal update 2/2012

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## Taxation Laws Amendment Act, 2011 - Taxation of unapproved insurance benefits

The recent changes to the Income Tax Act (“ITA”) have impacted on the taxation of the premiums and proceeds in respect of an employer owned unapproved policy. The main changes effective 01 March 2012 which impacts on Momentum Employee Benefits and relating to pure risk policies are:

- Employers must ensure that the premiums paid on behalf of an employee are taxed as a fringe benefit in the employee’s hands.
- The employer can then claim a deduction for the premiums in terms of section 11(w)(i) of the ITA.
- Proceeds received will then also be tax exempt in the employee’s hands unless the employee was entitled to a further deduction in terms of section 11(a) of the ITA for example in the case of a disability income benefit.
- If the employee was entitled to a deduction in terms of section 11(a) of the ITA, then the policy proceeds will be taxable.

	<b>Lump sum</b>	<b>Disability income</b>
<b>Employer</b>	Deduction for premiums paid	Deduction for premiums paid
<b>Member</b>	Premiums taxed as fringe benefit	Premiums taxed as fringe benefit & deduction for premiums
<b>Duty of employer</b>	Include fringe benefit for PAYE	Include fringe benefit and deduction for PAYE
<b>Benefit</b>	Tax-free – exemption will apply	Taxed – included in gross income, no exemption

A detailed explanation of the changes is provided below.

### Taxation of proceeds

For *unapproved* (selfstanding) insurance policies, all amounts received in terms of a long-term insurance policy will initially be included as gross income. Thereafter certain exemptions may apply.

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## Exemptions

Basically the exemption applies where:

- (i) the premiums were paid from *after / post-tax* money, or
- (ii) the premiums were paid from *before / pre-tax* money and if the premiums were taxed as a *fringe benefit* in the hands of the employee.

Provided that the employee is not entitled to a further deduction for the premiums as in the case of a disability income benefit. In this case, the policy proceeds will be taxable in the employee's hands.

### An exemption for the policyholder (employer) where the proceeds were intended for the employer

The exemption applies to a keyperson policy. At Momentum Employee Benefits we do not have these types of policies.

### An exemption for the employee where the employee or his dependants or nominees receive the proceeds

Proceeds received on or after **01 March 2012** will be *tax exempt* in the employee's hands in the following cases:

- For pure risk policies (which are the policies we provide at Momentum Employee Benefits e.g. unapproved lump sum death, lump sum disability, dread disease, Funeral and Family Protector), where the premiums paid by the employer on behalf of the employee on or after 01 March 2012 were taxable in the hands of the employee as a fringe benefit.

However, if the employee was taxed on the fringe benefit but entitled to a further deduction under section 11(a) of the ITA for example in the case of an disability income policy, the policy proceeds will be taxable in the employee's hands.

- For any other policy (not a pure risk policy), only if all premiums paid on the policy (both pre 1 March 2012 and post 1 March 2012) were in fact taxed as a fringe benefit in the employee's hands.

If the exemption applies, then for the purposes of PAYE, there is no obligation on the employer to declare this as income in the employee's tax certificate.

## No exemptions for proceeds

No exemption for the employee or his dependents applies where the premiums were paid with pre-tax money and where the employer did not tax the premiums as a fringe benefit in the employee's hands. In such a case the employer will be obliged to deduct employee's tax from the proceeds.

## Deduction of premiums

### Lump sum benefits

The employer can claim a deduction for the premiums provided that the premiums are taxable in the employee's hands as a fringe benefit. The employer must take the fringe benefit tax into account for PAYE purposes. The employee is not entitled to any deductions.

### Disability Income benefit

The employer can claim a deduction for the premiums and the premiums will be taxable in the employee's hands as a fringe benefit. In this case, the employer is *obliged* to take into account the deduction to which the employee is entitled in terms of section 11(a) for purposes of calculating the employee's tax<sup>1</sup>.

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<sup>1</sup> Par 2(4)(cA) of the Fourth Schedule

There will be an inclusion for fringe benefits tax but also a corresponding deduction of the premiums for the employee, which means that the employee will be in a tax-neutral position. The employer must take the fringe benefit tax *and* deduction into account for PAYE purposes.

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