Dear Sir/Madam,

CALL FOR COMMENTS: DRAFT VAT 421 GUIDE - SHORT TERM INSURANCE

We refer to the call for comments on the above mentioned Draft VAT Guide (“the Guide”). Set out below please find the SAICA National Tax Committee’s submission comments.

Introduction
We appreciate and acknowledge the effort that must have gone into the preparation of the Guide. We wish to congratulate SARS with a comprehensive and well written document.

Having said the above though, our understanding is that the guide is aimed at assisting formally registered insurers as well as vendors operating outside the formal insurance industry. In this regard the main users of the guide will be insurers and insureds in terms of contracts of insurance.

It is our understanding that the treatment of transactions within the insurance industry are being discussed and negotiated with the Commissioner with the assistance of the South African Insurance Association (“SAIA”). The ruling issued by the Commissioner to the insurance industry at large is also being discussed in that forum and will act as the guiding principles for the insurance industry internally. This submission is not aimed at augmenting or
interrupting the before-mentioned process. It exclusively deals with the guide in its current form. The remainder of the commentary must be viewed in the light of the above.

Technical nature of the document
While efforts were made to steer clear of a technical focus, readers that are not familiar with the insurance industry will likely find it difficult to follow the text and the application of technical issues. The document gives the impression of an academic dissertation on the topic that was afterwards converted to a guide – this approach is always challenging in practice due to the differing focal points.

For example, Chapter two will be of little interest to a person wishing to utilise the guide as a compliance tool. Chapter three also deals with issues at a very technical level. Instances where the writer had the opportunity to align the content with day-to-day challenges have been missed. For example the last paragraph on page nine reads as follows:

In Chapter two it states that “This guide is concerned mainly with insurance business conducted within the meaning of “short-term insurance policy” as defined in terms of the STIA.” In practice various difficulties arise where suppliers provide what essentially constitutes insurance cover to its clients (for example cover while goods are in the post/being delivered). Formal contracts of insurance do not exist and the entities are not registered as insurance companies. We recommend that these issues also be dealt with in the final version of the guide.

At the top of page 12 several principles applicable to subrogation are listed. In our opinion this is technical detail that does not necessarily add to the ability to deal with insurance challenges in practice.

Chapter three contains detail that in a sense clutters the main messages. A crisp summary of the various principles (or a decision tree) may be more user-friendly.

The critical issues in Chapter four are the roles that underwriting managers, claims or policy administrators, brokers and sub-brokers, collecting agents and canvassing agents play in the overall supply chain. Currently the various role players are only listed. We recommend that this issue be dealt with in more detail, ideally in tabular form.
Chapters five & six contain detail that does not necessarily assist with the application of the various principles. We recommend that the various principles be summarised in tabular form or in a decision tree format.

Specific comments
Chapter One
We cannot agree with the statement made in the first sentence of the second paragraph under paragraph 1.1, as it seems to be factually incorrect in view of paragraph 3.15 of the VATCOM report. We recommend that this sentence be deleted.

Incorrect reference (page 6, paragraph starting with “Chapter 6”) - in the third line, the sentence starting with “From the insurer’s perspective” should read ‘From the insured’s perspective’.

Chapter Two
We have difficulty in understanding the relevance of Chapter 2 in view of the objectives of the Guide as set out in the first paragraph under the Foreword.

With regard to paragraph 2.3 the ordinary meaning of “insurance” seems to be irrelevant in view of the fact that the statutory definition of “insurance” in section 1 of the VAT Act No. 89 of 1991 (“the VAT Act”) prevails.

We recommend that paragraph 2.4 be amended to clarify that all insurance written under the Long Term Insurance Act No 52 of 1998 (“LTIA”) including, for example, personal accident insurance written as part of a long-term insurance policy is exempt from VAT, whereas all insurance written under the Short-term Insurance Act No 53 of 1998 (“STIA”), including personal accident insurance written as part of a short term policy, is taxable.

Paragraph 2.4 should recognise that any insurance or guarantee against loss, damage, injury or risk of any kind fall within the ambit of the VAT Act, and not only insurance written under the STIA.
We recommend that this chapter also deals with non-traditional/regulated insurance arrangements – see comments above.

**Chapter Three**

Paragraph 3.3 Registration of insurers with the FSB: The statement that a person must be registered with the Financial Services Board and be approved as a “short term insurer” or a “long term insurer” in terms of the relevant Act(s) to be able to conduct insurance business legally in South Africa, is not factually correct. For example, car rental companies are not required to register with the FSB and also do not fall within the ambit of the STIA. The definition of “insurance” in the VAT Act is therefore not applicable only to FSB registered insurers.

**Chapter Four**

Paragraph 4.3 contains a reference to the documentary requirements under paragraphs 4.4 and 5.5 regarding the documentation relating to commissions and the collection of premiums. However, neither of these paragraphs describes the documentary requirements for commissions or for premiums, apart from the reference to section 54(3).

The reference in the last paragraph on page 22 to “independent contractor” should read “independent intermediary”.

It is essential for the guide to provide guidance with regard to the documentation that must be issued by the agent (encompassing all the types of agents or intermediaries listed under paragraph 4.4) in respect of its fees or commissions to enable the insurer to claim an input tax deduction on such commission or fee in view of the fact that separate tax invoices are not normally issued in the industry. Generally in the insurance industry the bordereau or commission statement serves as the tax invoice provided all the relevant information as required by section 20(4) is reflected thereon.

We further recommend that a more complete analysis be provided of the roles and identity of the underwriting managers, claims or policy administrators, brokers and sub-brokers, collecting agents and canvassing agents. Ideally this should be done in a tabular format.
Example 3 on page 21 is of a highly technical legal nature. In our opinion it is unlikely to be of benefit to the user of the manual. We recommend that the example be replaced by a more “down-to-earth” example.

**Chapter Five**

Paragraph 5.3.2 first paragraph - the reference in the last sentence to the “management of a superannuation schemes” is grammatically incorrect.

Paragraph 5.3.2 last paragraph on page 25 and first paragraph on page 26 - In a Guide of this nature it is essential that it explains in more detail and with examples of the type of insurance transactions that will qualify for the rate of zero percent under each section, for example:

- International transport insurance (section 11(2)(d)) with an explanation of what is meant by international transport, and/or reference to travel insurance and marine insurance;
- Insurance of land or improvements thereto situated outside SA irrespective of whether the insured is a SA resident or not (section 11(2)(f)); and
- Insurance of movable property situated outside SA irrespective of whether the insured is a SA resident or not (section 11(2)(g)).

Example 5: The Guide is aimed at short-term insurance and therefore we recommend that an example be included that excludes long-term insurance premiums. In addition, only reinsurers are entitled to carry on long-term and short term insurance in the same entity. We further recommend that the guide confirms that commission paid to agents or intermediaries and insurance indemnity claim payments are expenses which are directly attributable to the taxable insurance services provided, and are not considered to be overhead expenses which must be apportioned. The Guide should also stipulate that where an insurer outsources its investment portfolio, that the portfolio management fee will be wholly attributable to exempt supplies where the investment portfolio comprises only of South African investments.

With regard to the bullet points on the top of page 28, we recommend that the Guide also stipulates that where an insurer repairs or reinstates damaged goods or replaces lost goods or goods damaged beyond repair, or acquires services in relation to the claim, that the insurer is entitled to claim the VAT based on the supplier’s tax invoice.
We would recommend that paragraph 5.3.3 confirms that an insurer is entitled to claim a section 16(3)(c) deduction also where the insurer pays a third party directly to indemnify a insurer in terms of a policy of insurance.

Paragraph 5.3.3 should also provide clarity with regard to the VAT status of claims where an insurer replaces a motor car stolen or damaged beyond repair, and where the insurer provides an insured with a rental vehicle in terms of the insurance policy whilst the insured’s damaged vehicle is being repaired.

With regard to paragraph 5.4.1 we recommend that the Guide also deals with the time when the VAT must be accounted for on annual premiums paid monthly, i.e. as and when the premiums are paid, and with annual premiums funded by insurers or third parties.

Paragraph 5.4.2, third last sentence should be amended to replace the reference to “intermediary” with “insurer” i.e. it is the insurer that should be informed when the intermediary receives premiums late, to enable the insurer to account timeously for the VAT on these late premiums.

Paragraph 5.4.3 should also deal with business placed with open market Lloyds’ correspondents and clarify that the premiums paid in terms of such policies are not subject to VAT.

Paragraph 5.4 should clarify the VAT status of premiums paid to reinsurers as well. For example, where a marine insurance book is reinsured with a local reinsurer, the premiums attract VAT at the standard rate as opposed to the premiums paid to the insurer which may qualify for the zero rate.

Paragraph 5.5 at the top of page 31, we are not in agreement with the approach as explained in the Guide under the first bullet under the heading “vendors”. With regard to vendor intermediaries, where the commission rate is applied to a VAT inclusive premium, no VAT should be added again to the calculated amount, as the calculated amount would already be inclusive of VAT. VAT should therefore only be added at the standard rate to the calculated amount if the commission rate is applied to the VAT exclusive premium. Where a zero rated
commission is calculated, the commission rate should be applied to the VAT exclusive premium. Example 6 in this regard is correct.

With regard to non-vendors (paragraph 5.5 at the top of page 31), the commission rate should be applied to the VAT exclusive premium. If the commission rate is applied to the VAT inclusive premium, it will exceed the prescribed maximum commission amount.

The Guide (paragraph 5.5 at the top of page 31) should also clarify the effective date from which the previously non-registered intermediary is entitled to charge VAT in terms of section 67(3) on its commission. If the intermediary fails to register for VAT and the effective date of registration is applied retroactively for, say, three years, the intermediary should not be entitled to collect VAT from the insurer prior to the actual date of registration, even if the effective date of registration is made retroactively.

Paragraph 5.5 should also deal with the VAT status of reinsurance commission which an insurer received from a reinsurer for the placing of reinsurance business with the reinsurer.

Paragraph 5.7.1, second paragraph should distinguish between an amount recovered from a third party on behalf of the insured (such as the excess paid by the insured to the insurer) and the payment thereof to the insured in which case no output tax is payable by the insurer and no deduction may be claimed by the insurer, and an indemnity payment made to the insured in which case a section 16(3)(c) deduction may be claimed even if the insurer subsequently recovers an amount from the third party (on which no output tax is payable).

Paragraph 5.7.1, second paragraph should also include payments received by an insured from a third party insurer.

Paragraph 5.7.2 should distinguish between local reinsurers (to which the VAT implications as set out in the paragraph apply) and foreign reinsurers which fall outside the scope of SA VAT.

Paragraph 5.9 seems to imply that the imported services provisions will only apply in the circumstances listed at the top of page 34. However, the imported services provisions will also apply in instances where the insurer outsources its investment portfolio to its foreign
head office or a foreign portfolio manager. The provisions will also apply where local insureds’ insure local assets which are not applied for taxable enterprise activities. We recommend that the Guide also deal with these scenarios.

Chapter 5 should also provide guidance with regard to the documentary evidence with is required by insured’s to claim VAT on insurance premiums and by insurers to claim VAT on reinsurance premiums and on commissions paid to intermediaries, because tax invoices are not generally issued by insurers, reinsurers or intermediaries.

The detail rules governing the payment of commissions on page 30 of the guide and the suggested manner in which commission should be computed (bottom of page 30 and top of page 31) should in our view not form part of the guide. SARS cannot be prescriptive on how vendors should arrange their affairs. It may cause SARS being made a referee in a match to which they are not party.

At the bottom of page 31 the guide reads as follows: “It should be noted that where an independent intermediary uses the services of a sub-agent in the above cases, the commission payable to the sub-agents cannot be zero-rated. This is because the services of the sub-agent are rendered to the intermediary in the Republic and are one step removed from the scope of the zero-rating provision which applies for commissions earned by the intermediary.”

In our opinion the above interpretation does not reflect the underlying law correctly. It is the actual services that are zero-rated in terms of the sections without regard to the receipt of the service. The charge of the sub-agent will accordingly also qualify to be zero-rated notwithstanding the fact that the service is rendered to the intermediary. The only requirement is the link to the international movement of people or goods.

Clarification of paragraph 5.4.2 - Premiums received through intermediaries - in terms of the STIA, when premiums are paid to brokers and collection agents that act as independent intermediaries, those payments should be made to the insurer within 15 days of the end of the month in which the intermediary received payment. However, for VAT purposes the tax period may only be reduced or extended by a period of up to 10 days. Therefore, if any late premiums are received by the intermediary in a case where the insurer has extended the tax period into the next month, the intermediary should be informed accordingly. Output tax on
premiums collected through intermediaries must therefore be accounted for by the insurer in the relevant tax period corresponding with the actual date that the premium was received by that intermediary.

The above paragraph needs clarification. There seems to be some confusion arising between tax period cut off and time of supply. We do not believe that the last sentence of the paragraph follows from what has been said previously.

Use of the word “and” instead of “or” (page 28 the fourth bullet point) - section 16(3)(c)(iii) of the VAT Act provides that an insurer is not entitled to a deduction of deemed input tax on a claim payment, where insurance premiums were subject to zero-rate VAT and the insured is a non-resident and a non-vendor. Therefore, the insurer is entitled to claim such deduction where the insured is either a resident, or a vendor. Hence, the insurer has to prove that the insured is a vendor or a resident and not both. We recommend the word “and” be replaced with “or”.

Chapter six
Paragraph 6.2 second paragraph should be expanded to include the reference to goods which are supplied to a vendor and which may be zero rated in terms of the provisions of section 11(1)(q) of the VAT Act.

Paragraph 6.3.3 should clarify that a vendor insured is liable for the section 8(8) payment on an indemnity payment received even if the underlying goods to which the payment relates is zero rated (such as animal feed or fuel), or falls outside the scope of VAT (such as cash stolen).

Grammatical error (page 40 - 4th line) - “severly” should be spelled “severely”.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

Piet Nel CA(SA) Muneer Hassan CA(SA)

PROJECT DIRECTOR: TAX SENIOR EXECUTIVE: STANDARDS

The South African Institute of Chartered Accountants