CHAPTER 2

LEGAL AND TAX ISSUES

Learning Outcomes

When you have completed this chapter you will be able to

- explain the concept of contractual capacity and list the types of persons who have no, or a limited, contractual capacity;
- explain the special adaptations to the common law principle of contractual capacity brought about by the Long Term Insurance Act;
- explain when insurable interest must be present;
- provide examples of insurable interest applicable to life insurance policies;
- explain the difference between *caveat emptor* and *uberrima fides*;
- discuss the implications of the reasonable man test as applicable to life insurance policies;
- explain how a lost policy document can be replaced;
- briefly describe the legislative protection afforded to life insurance policies;
- explain, in general terms, the miscellaneous restrictions and prohibitions applicable to life insurance policies and their marketing, including maximum commission scales;
- discuss how the cause of the death of a life insured may affect the payment of a claim;
- explain, in some detail, the restrictions applicable when a new policy is issued;
- describe a cession and its applications on a life insurance policy;

- explain the difference between an absolute cession and a security cession;
- explain the rights that a beneficiary appointed to a life insurance policy has;
- discuss, in some detail, the unique position of a beneficiary nominated on a retirement annuity and the rights that the beneficiary has;
- explain the impact that the Income Tax Act has on the employer and the employee if the employer owns a life insurance policy on the life of the employee;
- list and provide a general description of other taxation issues that apply to a life insurer.

2.1 CONTRACTUAL CAPACITY

To have a contract one person must make an offer that can be accepted or declined by the other person. Only once an offer has been accepted, is there a legal contract between the two people. No person is able to make an offer, or accept the basis of a contract, unless they have the ability to enter into a contract. We call this contractual capacity. While most people have the ability to enter into a contract, there are some who have only a limited contractual capacity and some who have no right or ability to enter into a contract at all.

2.1.1 PERSONS WHO HAVE NO CONTRACTUAL CAPACITY

Insanity

A person who has been declared to be insane is said to be unpredictable and therefore incapable of being held responsible for his actions.

Persons who are intoxicated

The common view is that any contract entered into by a person under the influence of either alcohol or drugs is invalid and will be declared invalid from the beginning.

Minor children under age 7

In the past, children under the age of 21 were said to be minors but with the passing of the Children's Act in 2007, the age of majority has been reduced to 18. There are two levels of contractual capacity applicable to minor children. Common law says that any child under the age of 7 is incapable of entering into any contract and so will need the help of a guardian for any contract, even to open a savings account.

2.1.2 PERSONS WITH LIMITED CONTRACTUAL CAPACITY

Minor children ages 7 to 18

Common law says that any child over the age of 7 but still a minor (under the age of 18) has only a limited contractual capacity. Such a child will still need the assistance of a guardian for the signing of a contract but not for the opening of a savings account.

2.2 INSURABLE INTEREST

There is a long history behind the need to make sure that there is an insurable interest when taking out an insurance policy. This need is possibly the single most important difference between an insurance policy and a gamble.

For an insurable interest to be present, the person taking out the insurance policy must be able to provide tangible evidence, if called upon to do so, that he will suffer a financial loss in the event of the insured event happening. This evidence must be provided at the inception of a life policy.

The need to show insurable interest can be traced back as far as the English Life Insurance Act of 1774, which was passed to prevent a “mischievous kind of gaming”. In essence the Act said that no insurance contract could to be taken out by any person, both natural or juristic, on the life of another person unless there is an insurable interest. It also made sure that no insurance contract could be taken out by way of gaming or wagering. Any insurance contract that broke these rules, was declared to be “null and void” or not legal.

The Gaming Act of 1845, while not making any specific mention of insurance or insurable interest, said that all contracts or agreements, whether verbal or in writing, would be null and void if they were gaming or wagering. This was, in fact, the first time that all contracts made by way of gaming or wagering were declared void and unenforceable by law, whatever their form or subject matter. The need for an insurable interest was therefore established in English law.

An insurable interest is no less important in South Africa than elsewhere. The Cape Province decided, in 1902, to use almost the exact wording from the Gaming Act of 1845 in the “Betting Houses, Gaming Houses and Brothels Suppression Act, 36 of 1902".

The fact that wagers or bets, in the other provinces cannot be enforced is based on Roman-Dutch Law. The South African courts have accepted the view of the Roman-Dutch writers from the end of the eighteenth century, that all gaming or wagering contracts are unenforceable. It therefore means that proof of insurable interest is needed throughout South Africa.

For Information Only (not to be examined)

While no mention of insurable interest as such appears in the South African Long Term Insurance Act of 1998, the legislation of our neighbour, Botswana, does. Whilst there is no actual definition of insurable interest, the Botswanan legislation applicable to the insurance Industry (which comprises chapter 46 : 01 of the legal code) states, in Section 66:

(a) Subject to the provisions of this Act, no policy of insurance shall be issued on the life or lives of any person or persons, or on any other event or events whatsoever, wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no insurable interest.

(b) An insurable interest shall be deemed to be had by -

- a parent of a minor or the guardian of a minor but only to the extent as provided by Section 77 (a maximum of P2 000 on a minor who has not yet attained 16 years of age);

- a husband, on the life of his wife;
- a wife, on the life of her husband;
- any person, on the life of another upon whom he is wholly or in part dependent for support or education;
- a company or other person, on the life of an officer or employee thereof; and
- a person who has a pecuniary interest in the duration of the life of another person, in the life of that person to the extent only of that pecuniary interest at the outset.

The need for insurable interest is alive and well in Botswana and, should an issue regarding insurable interest be raised here, there is little doubt that any insurable interest that can be shown to apply in terms of the Botswanan legislation would also be accepted as applicable in South Africa.

2.2.1 WHEN MUST INSURABLE INTEREST BE PRESENT?

In the case of *Commercial Insurance Co. vs Kern* the court decided that - "*The fundamental principle is that once the insured is deprived of his insurable interest in the insured car, the policy ceases to have any validity*". This means that in a claim under a short term contract, the insurable interest must be established, both at the time that the contract is taken out and also at claim stage.

In the case of *Rixom vs Southern Life Association of Africa & Collins & Bain* the court decided that - "*Insurable interest must be in existence at the beginning of the contract*". As this decision was about a life insurance policy, it is now accepted as applying to all life policies. In a life insurance contract one must therefore prove insurable interest at commencement only.

In fact, when a person insures his own life and then nominates someone else to receive the money when he dies, such as a beneficiary or cessionary, the beneficiary or cessionary, once the life insured has died, can sue without showing an insurable interest, unless the beneficiary or cessionary had actually taken out the policy and paid the premiums.

The insurable interest need not even continue for the full term of the policy contract. Should a creditor insure the life of a debtor, the creditor will be able to receive the full value of the policy when the debtor dies.

2.2.2 EXAMPLES OF INSURABLE INTEREST

On the insured's own life

It is perhaps fair to say that insurable interest becomes irrelevant when the policy is on the insured's own life. Insurable interest is really only needed as proof of the **good faith** of the people involved in the contract. It is unlikely that a man would insure his own life just to provide for the payment of money to someone else, although cases where this has happened are not unknown. It is generally accepted that every person has an unlimited insurable interest in his own life.

On the life of a spouse

It is usually accepted that there is an unlimited insurable interest between spouses. There may be no direct legal basis for this assumption but there has been a test case where this was accepted.

On the life of a fiancée

There is some opinion that accepts that a person has some right to expect a financial advantage from the continued well-being of a fiancée. In practise it is usually accepted that an engaged couple have the same level of insurable interest in each others' lives as a couple who have already married.

On the life of a relative

A person has a legal right to claim support from a relative, and so an insurable interest exists. In South African law, both parents are under a legal duty to support their children (legitimate and illegitimate). If they cannot support their children, the duty passes to the grandparents.

Note

Only maternal grandparents can be held responsible for the support of an illegitimate child.

Also, a person who cannot support himself as a result of either a mental or physical disability, can claim support from a brother and/or sister, if the parents are unable to provide it. A child must also support an infirm parent or grandparent. This legal duty creates an insurable interest. The insurable interest is based on, and limited to, the actual loss of maintenance that might occur if the person providing the support dies. To establish the amount of insurable interest, the ages, state of health and wealth of both parties must be looked at.

It has become common practice for parents to take out life insurance policies on the lives of their children for the purpose of covering possible educational or funeral expenses that may arise in the future. Insurers in South Africa have generally accepted these proposals with the proviso that the level of life cover included with the application is at a reasonable limit.

Note

Parents in fact do not have an insurable interest in the lives of their children under normal circumstances. The issuing of a policy is a concession made by the insurer(s) concerned. This does not make the policy invalid. Common practice over the years has made this an acceptable business practice, provided that the level of life cover is justifiable.

A person may also have insurable interest in the lives of his parents-in-law or family-in-law, or against whom he may have a contractual or common law right of support. The insurable interest may even be further extended to any person who *de facto* maintains the insured.

Creditor on the life of a debtor

A creditor has an interest in the continued health of a person who owes him money. In general, any contract where one person expects to get some benefit out of the continued health of another suggests a need for a legitimate contract of insurance. Insurance is allowed at least to the value of the debt plus some reasonable interest.

Business Partners

Business partners create an insurable interest in each others lives when they sign an agreement to pay money to the estate of a partner that dies. The agreement, which must be binding, limits the insurable interest to the amount that must be paid to the estate on death. The same will apply to shareholders in a company and members of a close corporation.

Employers on their employees

An employer has an insurable interest on the life of an employee if it can be established that the earnings of the company rely on the employee's skill or services. Remember, however, that a company can only insure the life of a shareholder if the shareholder is an employee. Here the insurable interest is limited to the worth of that employee to the company and not by his status as a shareholder.

Employees on their employers

An employee who has a contract for a fixed number of years at an agreed salary has an insurable interest in the life of his employer equal to of the value of future salary due to insecurity and uncertainty.

2.3 PRINCIPLES OF AGREEMENT

2.3.1 MUTUAL AGREEMENT (*CONSENSUS AD IDEM)*

For there to be a basis for the establishment of a valid life insurance contract between the proposer and the insurer, there are a number of areas where agreement must have been reached. The proposer and insurer must have agreed on:

- the proven identity of the insured person;
- the risk that has been insured against such as life cover only or with supplementary benefits;
- the amount for which the insurer will be at risk or sum insured;
- the value of the premiums due by the policyowner in terms of the contract; and
- the period of the insurance or the term of the contract.

2.3.2 *CAVEAT EMPTOR* VS *UBERRIMA FIDES*

There are two distinct ways that contracts can be set up. These have substantial legal differences.

Caveat emptor

In all your business dealings you undertake some form of contract, even if most of these are simply verbal. Examples of these are: the purchasing of a loaf of bread, or a packet of cigarettes from your local shop. Some contracts will not be as simple. They could be for large amounts, such as the purchase of a car or even a house.

All of these contracts that you undertake will be based on *caveat emptor* or, in English, "let the buyer beware". The terms and conditions offered by the seller are either queried when you buy, or else you accept that they are true and correct. There can be no comeback, unless the seller gives you some form of warranty.

It is often thought that there is a "cooling off" period when a major purchase is made. This is, strictly speaking, not correct. The cooling off period applies only to any credit agreement that you may have signed. ASISA has a Code of Conduct, in terms of which life insurers allow a cooling off period of 30 days, during which an endowment or life cover policy may be cancelled without penalty.

Based on the principles of common law, you will be able to apply to the courts in the event of deliberate fraud or misrepresentation of the facts. However, ignorance of the facts cannot be accepted as a valid defence. You are expected to be aware of what you are signing or agreeing to at all times and, as is often repeated - "Ignorance is no excuse in the eyes of the law."

Uberrima Fides

The very nature of an insurance contract requires that the seller (the proposer and/or insured) provides the buyer (the insurer) with all the facts at his disposal. Non-disclosure or misrepresentation of any of the fact will give the insurer the right to claim that the policy was void from the beginning (*ab initio*). Over the years a certain amount of confusion has arisen as to whether insurance contracts are contract of utmost good faith (*uberrima fides*) or contracts of good faith (*bona fides*).

The often quoted case of *Mutual and Federal Insurance Company Ltd. v Oudtshoorn Municipality (1985)* finally cleared up this confusing principle. The Appellate Division decided that utmost good faith was an impractical concept since there can only be good faith or bad faith. A person may be less than honest but cannot be more honest than honest and utmost good faith was declared to be meaningless in South African law.

With a contract *uberrima fides* it was accepted that there was an obligation placed on the proposer to disclose all that he knows. The hiding of any material circumstance, whether the proposer thought it was relevant or not, would allow the insurer to void the contract from inception.

The implication of this and further court rulings has resulted in the conclusion that the principle of *uberrima fides* placed too heavy a responsibility on the proposer and the **reasonable man test** has been established.

Reasonable man test

While the basis of *uberrima fides is* still applicable to any proposal for insurance in principle, it is now accepted that the test of the validity of the contract will be determined by the reasonable man test.

The proposer is expected to provide an insurer with all the relevant information required that a reasonable man would know to be material to the risk. It will be no excuse to state that facts were not disclosed because you thought that they were not important or material. If a reasonable man would have recognised the facts to be material, the proposer is expected to also have recognised this.

This does not mean that every proposer needs to be an underwriter. The emphasis is on what a reasonable man would consider to be necessary. Unfortunately there does not seem to be a clear definition of what is considered to be a reasonable man. Where this has been put to the test, the opinion of a person with an average intelligence and some form of post-matriculation qualification was considered adequate. A knowledge of insurance, however, usually disqualifies the person as the opinion of a layman is what is required.

With a life insurance proposal there is, however, some information that will always be considered to be material and so must be disclosed.

1. **Insurance record of the proposer / insured**

   The fact that a policy has been cancelled, or that a previous proposal was declined, or accepted, at other than ordinary terms must be disclosed.

2. **Risk experience of proposer**

   Should the proposer have submitted a dread disease or disability claim at any time in the past and is now looking for cover for the same risk, this must be disclosed.

3. **Medical Questions**

   The following is a direct extract from **Gordon and Getz - The South African law of Insurance**.

   > "*In life insurance statements by a proposer as to his health are asked for and given on the basis of his belief, for the answers to medical questions are largely a matter of opinion. Although the proposer's opinion as to the materiality of a fact is generally irrelevant, if he is asked to state no more than what he believes to be true, it is sufficient that his belief be true.*
   >
   > *A proposer who makes a reckless statement cannot be said to believe in it's truth. If he "does not attempt to tax his memory, or really try to think about the matter, and apply his mind to it; if he was casual and negligent in the answers he gave", then he does not fulfil his obligation to disclose everything material to the insurer.*"

   So it can be seen that a proposer must provide honest and truthful answers to all the medical questions on the proposal form. Failure to do so can result in the insurer repudiating a claim due to the non-disclosure of a material fact. The insurer must, however, prove that the proposer was aware of the facts at the time of proposing.

The extent of the duty to disclose is well illustrated in the case *Pickering vs Standard General Insurance Co. Ltd.* The insured, although he had correctly answered questions on the proposal form regarding his health, had been aware of the possibility that he may have been an epileptic. Even though it was later established that he did not suffer from epilepsy, the court ruled that there had been a suspicion that he may have. He should have disclosed this fact to the insurer.

Provided as background information only

There are certain policy conditions which will automatically be declared null and void if an insurer should try to rely on them, whether they have been included or not.

Firstly, an insurer cannot claim exemption from liability for the actions, omissions or representations made by a person acting on its behalf in relation to a long term policy.

Secondly, no insurer can decline its obligations in terms of a long term policy, by claiming that the person who negotiated on behalf of the policyholder was not acting on behalf of the insurer.

Thirdly, an insurer cannot make the payment of a claim contingent on the admission of the claim by a reinsurer.

Fourthly, any provision in any documentation that waives the rights granted by the Long Term Insurance Act to any person entering into a long term contract, or the rights of a life insured under a long term policy, shall be void.

2.4 THE LONG TERM INSURANCE ACT

2.4.1 DAYS OF GRACE

The Insurance Act provides that if any premium under a life policy has not been paid on its due date, the insurer must maintain the policy in force for the full sum insured for a period of 1 month, 15 days where the premium frequency is monthly or shorter. This is regardless of anything else agreed to and contained in the policy. Should the overdue premium be paid during the days of grace the insurer must continue the contract. If a claim occurs during the days of grace the insurer is entitled to deduct the unpaid premium from the claim amount. (Section 52(1))

Should any premiums under a domestic life policy be unpaid and there is a remaining value which is greater than half of the average premiums due in the next twelve months, the insurer must either, issue a paid up policy or apply the non-forfeiture value of the policy to maintain the policy in force. Where a paid up policy is issued it must be issued free of any future need to pay any premiums. (Section 52(2))

2.4.2 PROTECTION OF CERTAIN LIFE POLICIES

Under the previous Insurance Act of 1943 there was specific protection for policies held by a wife on the life of her husband. In terms of the new constitution this would have been seen to be discriminatory and so needed to be addressed.

When the Long Term Insurance Act of 1998 was finally promulgated no protection of this nature was included in the Act. No mention has been made of the treatment applicable to any policy issued before January 1999, which was the date at which the Long Term Insurance Act came into force.

2.4.3 PROTECTION AGAINST CREDITORS

In the event of insolvency insurance policies have some limited protection in terms of the Long Term Insurance Act. There are two situations that may arise here:

(a) insolvency before death;

(b) insolvency of the estate of the deceased.

In the first situation we only consider the total cash values of all the policies that are the property of the insolvent. This may be the property of an individual or, in the case of a marriage in community of property, the property of the joint estate.

In the second situation we consider the claim values of all policies on the life of the deceased that were his property before his death.

In both situations, it is only the first R50 000 of the totals due that will be protected from creditors.

While we talk about policies owned by the insolvent, either alive or deceased, you must remember that any policies ceded before the insolvency that can be shown to have been ceded to the disadvantage of creditors can be included in the insolvent estate. Further, any policies owned by a spouse married *in community of property* will also be included in the insolvent estate.

2.5 MISCELLANEOUS RESTRICTIONS AND PROHIBITIONS

2.5.1 RESTRICTED INSURANCE ON CHILDREN UNDER 14

No insurer is allowed to insure the life of a child under the age of 14 for any sum over:

(a) R10 000 if the child is under 6 years or still unborn[1];

(b) R30 000 if the child is 6 years or older but under 14.

[1] "Unborn" means a human foetus conceived but not born

These amounts are cumulative, and so apply to the total cover on the life of the child, with all insurers.

A payment that is bigger than the limitations can be paid out if:

- there are investment profits included on with profit policies that exceed the restrictions;

  OR

- a refund of all premiums paid plus interest compounded annually exceeds the restrictions.

2.5.2 LIMITED RELIEF FOR MISSTATEMENTS OF AGE

In common law, stating an incorrect age in a proposal form would be a breach of warranty, and would entitle the insurer to cancel the policy. The Long Term Insurance Act, however, rules that the insurer can only adjust the sum insured and any other benefits, to the level that can be supported by the premium when this is recalculated using the real age of the insured.

2.5.3 ONLY THE RATE TABLE GIVEN TO THE REGISTRAR MAY BE USED

Every insurer must give the Registrar of insurance a copy of every table of the rates of premiums it will usually charge. The insurer must also give details of the benefits it undertakes to sell as policies on the lives of normal individuals.

Having done so, an insurer is not allowed to use any other table or policy benefits unless:

(a) the valuator reports that it is actuarially sound, and

(b) the insurer informs the Registrar.

This effectively stops the insurer from providing any once off discount and/or special offers without first getting the approval of the Registrar.

2.5.4 NO DISCRIMINATION

Linked with the previous point is a ban on discriminating between two lives insured where they have the same life expectancy. This means that all persons of the same age who are expected to die at the same age must be offered the same rates and conditions.

It does not, however, apply to:

(a) reinsurance contracts;

(b) policies for large sums insured offered at preferential rates if these are known to the Registrar; or

(c) policies insuring the lives of the employees of one employer on a group basis.

2.5.5 NO INDUCEMENTS

No insurer or its employees, agents or intermediaries is allowed to pay any amount as an incentive to any person for taking out a life policy or alter an existing one. This restriction applies to any direct or indirect offer that could be in cash or otherwise, for example, a part of the commission. Included in this restriction is also any discount, or rebate, of a portion of the first annual premium or a part thereof. Also no person is knowingly allowed to accept such an incentive.

2.5.6 NO CREDIT FOR THE FIRST YEAR'S PREMIUM

No insurer is allowed to accept any proposal for life insurance if the proposer offers to pay the first annual premium, or a part thereof. Any payment offered for the first premium **must** be payable on the date of issue. Insurers may, however, have the right to accept an obligation for the policyholder, if the insurer is satisfied that the arrangements are in place to collect the premium, for example a debit order or stop order.

2.5.7 CONDITIONAL SELLING

No person is allowed to lend money or provide credit and then insist that the loan or credit will only be granted if the borrower buys an insurance policy. Insisting that some form of security for the loan or credit is provided is, however, acceptable. Where a person borrows money or is granted credit the following conditions will apply:

(a) the debtor can be required to provide security for the debt taking into account:
  - (i) his creditworthiness;
  - (ii) any other security he may offer; and
  - (iii) any other relevant information such as a guarantor;

(b) where a new policy must be taken out:
  - (i) the policy must be reasonable in relation to the debt; and
  - (ii) the debtor must be allowed to choose his own insurer and use his own agent.

The type of policy can also be limited to a policy that only pays a benefit on the death or disability of the life insured. Should the borrower use an existing policy he must also be allowed to use his own intermediary to arrange the security cession of the policy and to make any changes that need to be made to the policy, in order that adequate security on death or disability is included with the policy.

To ensure that the above conditions are complied with the policyholder must confirm, in writing and before a security cession can be lodged with the insurer, that he:

- was given written notification of his freedom of choices as explained above;
- exercised that freedom of choice; and
- was not subjected to any coercion or inducement as to the manner in which he exercised that freedom of choice.

Note

The above does not apply where a policy is being taken out to provide security for a loan as controlled by the National Credit Act.

2.5.8 MAXIMUM COMMISSION SCALES

Part 3 of the Regulations to the Long Term Insurance Act, 1998, sets out the maximum rates of commission that may be paid to an intermediary. The Regulations are referred to in Section 49 of the Act which further dictates that no consideration may be offered or provided other than the commission as laid down in the Regulations.

2.6 CAUSE AND CIRCUMSTANCES OF DEATH

When it comes to the death of the insured the cause and circumstances are usually irrelevant. In most life policies the insurer must pay the claim regardless of whether death was due to a natural or accidental cause.

The occupation and/or activity that the life insured was following at the time of his death is often also irrelevant. There are, however, some causes of death that we must look at closely, especially if there are certain supplementary benefits included in the policy.

2.6.1 DEATH AT THE HANDS OF THE LAW

If the insurance policy is legally obtained but the insured is later convicted of a crime for which he is executed, the insurer does not have to pay the claim.

2.6.2 MURDER

The murder of the life insured is covered, it is a principle of common law that no person can benefit by causing the death of another person. Therefore, the murderer, and anyone claiming through him, can never benefit from the insurance, but the policy itself remains valid. The insurer is not relieved from any liability to the estate of the deceased.

Public policy will not allow the deceased's innocent heirs to suffer, and the insurer must therefore pay the proceeds to the heirs, or into the estate for their benefit if they are still too young.

2.6.3 SUICIDE

In South Africa suicide is not a crime. A person can also not be held liable if he encourages another to kill himself. However, the idea of suicide, or the encouraging to commit suicide, is however against public policy. There is, therefore, quite a lot of support for a limited suicide exclusion clause with a life policy.

Most, if not all, insurers in South Africa add a clause in the policy that will cancel the contract if death is by suicide within a set period. This period was initially 2 years although more recently only a 1 year period seems to be used.

Most insurers also have a similar exclusion for suicide on policies that have lapsed and are renewed again. However, some of the insurers that market assistance insurance have decided to do away with any form of suicide exclusion clause.

2.6.4 WAR SERVICE

The Long Term Insurance Act says that no insurer may refuse to issue a policy to any person because he is performing or is likely to perform military service.

The insurer can, however, exclude death as a result of military action, although the surrender value of the policy would still be paid out. Should cover for military service not be included the insurer will have to refund premiums in the event of the death of the insured.

This is only applicable to policies issued after 21 June 1978. An insurer who is prepared to cover a person for military service is allowed to charge an extra premium for the risk. Once the insured’s military duties come to an end, the policyowner may ask, in writing, for the extra premium to be cancelled. The insurer must agree but can exclude any future military activities.

2.7 RESTRICTIONS APPLICABLE TO NEW BUSINESS

Section 59D of the Insurance Act of 1943 has been replaced with Part 4 of the Regulations to the Long Term Insurance Act of 1998.

Section 54 of the Long Term Insurance Act which states that:

A long term insurer may not -

- *undertake to provide policy benefits, or provide policy benefits;*
- *provide consideration upon the surrender of; or*
- *make a loan upon the security of,*

a long term policy contemplated in the regulations, otherwise than in accordance with the requirements and limitations set out in the regulations.

The regulations mentioned are in Part 4 of the Regulations to the Long Term Insurance Act of 1998 and the important elements of this which impact on new business are summarised in the points set out below.

1. The minimum policy term must be 5 years. Where a policy contradicts one of the rules explained here the minimum term to maturity must start again. Therefore, a change to the policy outside the rules will result in the policyowner having to wait 5 years for his full benefit to become available to him.

2. Life cover is not necessary. It is possible for an insurer to issue pure endowment policies. Where the policy is a company owned sinking fund policy it is not even necessary to nominate a token life insured.

3. It is possible to have more than one life insured on a policy. The policy can also provide for the payment of benefits only on the death of the last dying.

4. You can substitute a life insured on a contract and delete the original life insured completely.

5. Policyowners will only be allowed one partial surrender or loan against the policy during the first 5 years. These rules also apply to existing policies and so only those policies issued before 1 March 1993 that, in writing, made provision for multiple loans will be able to grant such loans.

6. Increases in premiums are limited to a maximum of 20% per annum.

7. Payments of benefits, other than as a result of a claim, during a 5 year restriction period are limited to the greater of the surrender value, or a refund of contributions plus 5% interest.

8. Where a policy is to be fully surrendered during a restriction period the policyowner is only allowed to receive the total value of the policy if it does not exceed the value set out in point 7 by more than R2 500.

9. Benefits in terms of new policies can be paid during a restriction period if the claim is:
   (a) a death claim;
   (b) payment due on the birth of a child to the life insured;
   (c) a disability claim; or
   (d) a claim in terms of a health insurance policy.

10. The rules do not apply to any policy used to underwrite benefits available from:
   (a) a pension, provident or retirement annuity fund;
   (b) a friendly society; or
   (c) a benefit fund;

   provided that the benefits stay in the fund and are not ceded to a member. Benefits can be ceded to another fund similar to the one that the funds are currently in.

11. There is a definition of an annuity included in the legislation and, provided the definition is abided to, the rules also do not apply to an annuity. The definition means:
   (a) payments must be made at intervals not exceeding 12 months;
   (b) at least one of the payments must be made in the 31 days before to the end of the restriction period; and
   (c) payments in one 12 month period may not differ from the payments in the 12 months immediately preceding by more than 20% unless as a result of fluctuations within a linked portfolio.

12. The Minister of Finance may amend, at any time, by regulations published in the Government Gazette:
    (a) the interest rate of 5%;
    (b) the minimum period of 5 years;
    (c) the escalation factor of 20%; or
    (d) the number of loans or surrenders permitted in the restriction period, which currently is one only.

2.8 CESSIONS

In order to fully understand cessions you need to grasp the status of an insurance policy document. Insurance policy documents are the evidence of legal agreements between the insured and the insurer. The document therefore represents whatever value there may be in the contract. This value is the property of the policyowner. As the policy document is the only legal representation of this value it is important that a record is kept of any transfer of the value. This is done by ceding the document and recording the cession on the document.

It important that we know what the difference between an **absolute** cession and a **security** cession is.

2.8.1 ABSOLUTE CESSIONS

In an absolute cession the **cedent***,* the person making the cession, transfers all his rights in the policy to another person(s) called the **cessionary**. The cessionary does not need to be a natural person, it may be a company, bank, or some other legally constituted body. In an absolute cession the cedent keeps no rights whatsoever in the policy. The cessionary becomes the new owner of the policy. Only the cessionary may sue for the proceeds of the policy. He may even sue for the total value where he may have purchased the original policy and have received the cession for a lesser amount.

Some common absolute cessions

- ***Cession for value received***
  An endowment policy where the policyowner has been paying premiums for a number of years will have a substantial cash value. An investor can offer to buy the policy with its cash value from the policyowner. Once the purchase price has been agreed, the transfer of the policy from the cedent to the cessionary will be done with an absolute cession for value received.

- ***As a free gift***
  A policy can also be given as a gift, perhaps to a loved one or family member. A common absolute cession of this kind is the transfer of a policy taken out at birth by a parent to the child who is the insured on the child's 18th or 21st birthday.

- ***In accordance with an agreement***
  Partners in a business often agree that, on the death of one of the partners the other partner will purchase his interest in the business. To provide the funds for the purchase the partners can use insurance policies on each others lives. Often in a buy-and-sell agreement the buyers will be the proposers on the life insurance policy on the life of the seller. While this is common practise there is another way of arranging the insurance. The seller can propose for a policy on his own life. As soon as the policy is issued he cedes the policy to the buyer in terms of a clause in the buy-and-sell agreement. This is then a cession in accordance with an agreement.

- ***In terms of a duly registered ante nuptial contract***
  There are only certain limited protections available for an insurance policy in a marriage. These limited protections are restricted to a current maximum of R50 000 on the life of either spouse.

  When two people decide to get married, they need to set out the conditions of their marriage in an ante nuptial contract. The future husband or wife can include a condition in the ante nuptial contract that he will cede a life insurance policy to his future spouse. This is an extremely valuable gift, and can be extended to any children or future children, if it is also included in the contract. The advantages of this are:

  1. any policy ceded in terms of an ante nuptial contract will not be included in the estate of a deceased spouse. This will be so even if the estate of the deceased is insolvent. The policy will also be completely excluded when calculating any liabilities for estate duty and executor's fees;

  2. any policy ceded in terms of an ante nuptial contract will not be included in the estate of an insolvent spouse. As long as the ante nuptial contract has been in existence for at least 2 years the policy will not be available for the payment of creditors, regardless of its current value at the time. The value of the policy will also not be included when calculating the protection available on any other policies that are to be included in the sequestrated estate.

This form of cession should therefore be considered by every couple contemplating marriage.

2.8.2 SECURITY CESSIONS

The cedent pledges the proceeds and value of the policy as security for a debt without giving up the ownership of the contract. This type of cession is commonly used when a loan is taken from a bank or building society. The cedent cedes the policy to the institution as security for the loan. Once the loan has been repaid the cession must be cancelled and the full rights of the policy will go back to the cedent.

2.8.3 FORMALITIES ATTACHED TO A CESSION

A contract of cession may be made orally although it has often been said that a cession is only complete when written confirmation of the cession has been handed by the cedent to the cessionary.

It seems to be generally accepted that the cession is not complete until the policy document has been given to the cessionary. However, it is only when there are competing claimants that this rule will apply. An uncontested cession will be accepted as valid even if the cessionary does not actually have the policy document.

An important point that is often overlooked is that the insurer does not have to be told of the cession and cannot be held responsible if it pays to the incorrect party. In practise the insurer will be informed and will add the cession to its records. However, the party claiming that a cession exists will be the one that has to prove it.

2.9 BENEFICIARIES

In South African law one person in a contract can promise the other person that he will award some benefit to a third person who is not part of the contract. This is a convenient way to include a third person as a beneficiary under a life policy. The contract between the insurer and the insured does not give any rights to the third person. He gets those rights only by accepting the benefit when it is offered to him.

The beneficiary under a life policy is only nominated to receive the proceeds of the policy when they become due. He may be either the insured himself, or his estate, or a third person who was not included in the insured's contract with the insurer.

We cannot presume that a married person who takes out a policy, intends to benefit his spouse and/or children. Where there is no nomination of a beneficiary, the proceeds will not be paid to a surviving spouse and/or child. The proceeds will have to go into the estate.

While the insured is alive a policy payable to himself or to his estate is an asset owned by him. It is his right to dispose of it as a legacy in his will. The policy can also be taken by his creditors and will become the property of his trustees if he were to be declared insolvent.

2.9.1 THIRD PARTY AS BENEFICIARY

To include a third person as beneficiary in a policy we use *stipulatio alteri*. The proposer and the insurer agree with each other to pay the benefits of the policy to a third person.

The *stipulatio alteri* itself creates no contract between the insurer and the third person **until such time as the third person accepts the nomination as beneficiary**. An insured can change the nominated beneficiary while he is alive as he chooses unless the nomination is irrevocable.

A beneficiary may be nominated by name, description or both. Where a name alone is used the nomination is clear. Where the nomination includes a description (for example, my wife), or is only a description, confusion can arise if the relationship between the policyowner and the third person changes.

In this situation, the courts have usually favoured the person who has been named as beneficiary. A nominated beneficiary does not have to be clearly identified at the time that the nomination is made. It is possible for a policyowner to simply nominate "my future children."

2.9.2 REVOCABLE NOMINATIONS OF BENEFICIARIES

When determining the rights of a beneficiary in terms of an insurance contract you must first establish whether the nomination is revocable.

Before acceptance
Before the nominated beneficiary has been offered the proceeds of the policy and has accepted the benefit, he has no rights. The insurer and insured can cancel or modify any benefits on the policy contract by mutual agreement.

After acceptance
Once the nominated beneficiary has accepted the benefit offered to him he gets the rights of a party to the contract. Benefits cannot be taken away without his permission and if the insurer fails to meet the claim he can sue. However, the beneficiary also acquires corresponding obligations with his rights. As a result, should the insurer have been in a position to claim nondisclosure or breach of warranty against the insured, the same defence can be used against the beneficiary.

Time of acceptance
It is only **after** the event insured against that the nominated beneficiary or his representatives is given an opportunity to accept the benefit. Until the event insured against has happened and the beneficiary has accepted his nomination he will have no rights.

2.9.3 IRREVOCABLE NOMINATIONS OF BENEFICIARIES

Under an irrecoverable beneficiary clause, your beneficiary acquires full rights the moment he accepts the nomination in writing. This means that whilst the insured is alive, he is not allowed to change or revoke nominations without the express consent of the beneficiary.

Conclusion
The importance of a beneficiary nomination must not be underestimated. Where there is a difference between the stipulations in a will and the nomination of a beneficiary on a life policy, the courts will favour the beneficiary nomination on a long term policy.

This clause in a proposal, which is usually treated as being relatively unimportant, is one which needs to be explained to the proposer.

2.10 BENEFICIARIES AND RETIREMENT ANNUITIES

It is possible to nominate a beneficiary who will then receive the proceeds of a retirement annuity if the purchaser dies before retirement. A retirement annuity contract is not a policy document but merely a certificate of membership of the retirement annuity fund. However, the value that builds up in the fund belongs to the purchaser and he is entitled to indicate what his wishes are with regard the value after his death. Nominations cannot be irrevocable and will always be subject to the conditions imposed by the Pension Fund Act 24 of 1956 (as amended).

Retirement annuities are governed by the Pension Fund Act 24 of 1956 (as amended). In order to establish what is allowed for the nomination of a beneficiary on a retirement annuity, we must refer to this Act. The allocation of pension benefits on the death of a member before retirement is set out in Section 37C.

1. Any benefit payable by the fund in respect of a deceased member will not form part of the assets in his estate. They must further be dealt with in the manner set out herein.

   (a) If the fund within twelve months of the death of the member becomes aware of or traces a dependant or dependants of the member, the benefit shall be paid to such dependant, or in such proportions as may be deemed equitable by the person managing the business of the fund, to such dependants.

   (b) If the fund does not become aware of or cannot trace any dependant of the member within twelve months of the death of the member, and the member has designated a nominee who is not a dependant to receive the benefit or a portion thereof, the benefit or portion thereof is to be paid to the nominee. The designation to the fund must have been in writing.

   If the debts of the estate of the deceased exceed his assets, the shortfall will be made up out of the proceeds of the retirement annuity and only the balance will be paid out to the nominee. The payment to the estate will be in the form of a commuted lump sum.

   (bA) If a member has a dependant and has also nominated a beneficiary who is not a dependant, the fund shall within twelve months of the death of the member pay the benefit to the dependant and the nominated beneficiary. It is the duty and responsibility of the person managing the fund to determine what proportions of the benefits will be paid to the relevant parties.

   (c) If the fund does not become aware of or cannot trace any dependant of the member within twelve months of the death of the member and if there is no nominated beneficiary or the nominated beneficiary has predeceased the member the benefit will be paid into the deceased's estate. Should there be no inventory submitted for the estate (the estate being too small and the member dying intestate) the benefit will be paid into the Guardian's fund. **Payment will be in the form of a commuted lump sum**.

2.11 THE INCOME TAX ACT AND INSURANCE

Since the discontinuance of the Sixth Schedule to the Income Tax Act the only policies that are affected by the Income Tax Act are those that are owned by an employer on the life of an employee. The policy needs to conform to the terms and conditions in Section 11(w) of the Income Tax Act. Should they not do so the policies will only need to be in line with Regulation 4 of the Long Term Insurance Act. There is no tax implication linked with policies that are controlled by Regulation 4 only.

There are two sides to the tax implications on a policy that is affected by Section 11(w) of the Income Tax Act - the employer's and the employee's.

2.11.1 THE EMPLOYER

In terms of Section 11(w) of the Income Tax Act there will be allowed as a deduction "*an allowance in respect of any premium which was actually paid by the taxpayer under any policy of insurance taken out upon the life of an employee of the taxpayer*". In the case of a company the deduction will also apply if the policy is on the life of a director.

Provided that -

(a) the policy was the property of the employer;

(b) only the taxpayer was entitled to a benefit under the policy and there was no loan outstanding against the policy unless the loan was made by the taxpayer in order to obtain funds needed because the employee was in ill health, infirmity, incapacity or had retired or left;

(c) the policy is a term insurance policy, or a policy that conforms to certain regulations that have been set by the Minister of Finance;

(d) the deduction will be limited, in the case of a conforming policy, to an amount equal to 10% of the remuneration of the employee or director.

Taxation Laws Amendment Act, 7 of 2010: Employer- owned policies

Premiums on employer-owned life insurance policies such as key person or deferred compensation policies will be tax deductible as from 1 January 2011, only if one of the two following conditions are met.

Condition 1

- The premiums are included in the taxable income of the employee or director as a fringe benefit.

OR

Condition 2

- The policy is owned by the employer, paid for by the employer and the employer is to receive the benefit. If there is a collateral (security) cession on the policy then the premiums may still be claimed as a deduction, unless the cession is in favour of the life insured, his relatives or dependents.

- The policy is taken out on the life of the employee or director to insure the employer against any loss arising as a consequence of the death, disability or severe illness of the employee or director.
- The policy is a pure risk policy - there must be no cash value to the policy.
- There must be no transaction, operation or scheme in existence in terms of which the benefits will be paid directly or indirectly to the life assured employee or director, his relatives, his estate or his dependents.

Practical implications - Existing key-person or personal liability policies

If either of the two conditions are met, then irrespective if the policy was originally set up as conforming or non-conforming, and irrespective of whether the deductions are factually claimed, as from 1 January 2011 the premiums will be fully deductible. The proceeds of policies that meet the conditions will be taxable to the extent that the premiums were deductible.

If neither of the conditions are met, then irrespective if the policy was originally set up as conforming or non-conforming, as from 1 January 2011, no premiums will be deductible. The proceeds of certain of the policies may still be taxable to the extent that the premiums were deductible under the old regime.

2.11.2 THE EMPLOYEE

At retirement the employee will **not** be receiving the proceeds of an insurance policy. The money received by the employee from his employer at retirement is in the form of a gratuity which can be funded from any source. The gratuity is included in the gross income of the employee.

In terms of Section 10(1)(x) of the Income Tax Act a lump sum amount not exceeding R30 000 is exempt from tax. Any other amounts previously excluded from tax as a result of this section (in the current or any previous year of assessment) will reduce the amount of the exemption allowed. No exemption under this section will apply unless:

(a) the person receiving the amount has attained the age of fifty-five years; or

(b) the employee is relinquishing, terminating, losing, repudiating, cancelling, or varying his office or employment as a result of superannuation, ill health or other infirmity; or

(c) the employee is retrenched as a result of the employer ceasing his business or down-sizing.

Note

In terms of the 2010 budget, it is proposed to merge this exemption into the retirement lump sum tax exemption, treating all retrenchment and retirement lump sum payments in the same manner.

Where the taxable income of our taxpayer, after having received the exemption, still includes an amount received by way of a gratuity, the normal tax payable on that amount is calculated using Section 5(10). This is the rating formula section and allows the taxpayer to pay tax at the average and not the marginal rate of tax.

2.12 OTHER GENERAL TAXATION ISSUES

2.12.1 GENERAL OVERVIEW

South Africa employs a range of methods of generating income for the government. The major types of taxation are as follows:

- income tax on the income and other earnings of private individuals and trusts;
- company tax on profits made in a business and a Secondary Tax on Companies (STC) which is levied on dividends declared[2];
- Value Added Tax (VAT) on most goods and services;
- customs (excise) duties and import charges, particularly special charges on various products such as petrol, liquor and tobacco;
- estate duty on the assets of deceased individuals with relatively large estates;
- donations tax on most transfers of assets via donations;
- stamp[3], transfer and company duties on a range of financial transactions including banking transactions, credit agreements, leases, marketable security transactions, insurance policies, business registrations, fixed property transfers, trust registration and legal agreements;
- other ad hoc income tax levies from time to time such as the special taxation levy imposed to assist with the funding of the change in government in the "New South Africa";
- Capital Gains Tax;
- toll road charges, although these can probably be argued o be not tax per se but fees paid to the concession holder for the upkeep of the roads.

In the balance of this chapter we deem income tax and company tax to be the most important considerations. A summary of the taxes relating to life insurance business is also dealt with.

2.12.2 PERSONAL INCOME TAX

As from 1 January 2001 income tax is levied on all residents of South Africa, regardless of where this income has been earned. Individuals, which are natural persons, are taxed on a sliding scale on their income.

In the 1995 budget steps were taken to ensure that income tax applies equally to all persons according to the laid down tables, although a separate scale applies to non-natural persons (excluding businesses), such as trusts.

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2 In his 2007 budget speech the Minister of Finance announced that the rate of STC would be reduced from 12,5% to 10% from October 2007 and then phased out in favour of a tax on dividends declared, payable by the company concerned.

3 The Stamp Duty Act was repealed in full from April 2009.

The tax rates start at 18% on the first R150 000 of taxable income per annum and move up to 40% on taxable income in excess of R580 000 per annum. (For year of assessment ending 2012.)

Persons earning below R60 000 per annum net are subject to a withholding tax called Standard Income Tax on Employees (SITE) whereby employers are obliged to deduct tax on income at source. (SARS is in the process of lifting this level.) Effectively SITE tax rates are the same as normal income tax rates, the only difference being that standard rebates are assumed and no tax return is required at the end of the year.

This means that SITE deductions are final in their nature and that SITE payers are not able to make use of tax-minimising strategies. Contributions made to approved pension and retirement annuity funds are, however, allowed to be taken into account at source for SITE purposes.

Note

Given the fact that the personal income tax threshold for taxpayers younger than 65 is approaching the SITE ceiling of R60 000, government proposes to repeal SITE with effect from 01 March 2011.

Persons earning over R60 000 per annum net submit tax either through regular Pay As You Earn (PAYE) withholdings or through six-monthly provisional tax with a final recalculation at the end of the tax year, being 28 February of each year.

The process of calculating Income Tax is as follows:

Calculate *general gross income*

(Remember to add specific inclusions such as lump sum proceeds, annuities, fringe benefits and other deemed income)

subtract *exempt income*

subtract *deductions*

then apply the tax table to determine the tax, remembering to take rebates off the amount in finding the tax payable, from which any tax already paid during the year should be taken off to find the balance due.

In his budget speech in February 2011 the Minister of Finance announced the following changes applicable to the 2011/2012 tax year.

The amount of interest exempt from tax is increased to R22 800 (and to R33 000 for persons over the age of 65), with the primary rebate increased to R10 755. The extra rebate for those over 65 is R6 012. Interest and dividend income from a foreign source - if taxable - is only exempt for the first R3 700.

Of particular importance, is the fact that the proceeds of life insurance policies are not taxed (except company-owned policies where premiums have been deducted for tax purposes) but there is no tax relief on premiums except to approved retirement funds (up to certain levels) and Permanent Health Insurance.

Lump sum proceeds from approved retirement funds are partly tax-free, compulsory annuities are fully taxed and voluntary annuities are taxed only on the interest portion thereof.

2.12.3 CORPORATE TAX

In the Budget speech the Minister of Finance announced a reduction in the corporate rate of tax on corporations from 29% to 28%, other than certain organisations which are specifically given tax free status, and mining and related companies (which are taxed separately) on non-dividend income.

Essentially all profits and income except dividends are included in the tax calculations but expenses incurred in the business (except those related to gaining dividends) are deductible. Rates of tax for certain categories of small business corporations whose tax year commences after 1 April 2000 were introduced as an incentive to job creation.

The tax paid by businesses tends to be based on a flat rate, with a concession of a two-tier rate for small business corporations. Qualifying small business entities now also pay tax at a further reduced rate. On up to R59 750 of taxable income, they now pay 0% tax. From R59 751 to R300 000, they pay tax at a flat rate of 10%. On any taxable income in excess of this amount, they pay tax at 28%.(2011/2012 tax tables)

A small business corporation means any close corporation or private company, the entire shareholding of which is at all times during the year of assessment held by shareholders or members who are natural persons, where -

(i) the gross income for the year of assessment does not exceed R14 million;

(ii) not more than 20% of the gross income of the company or close corporation consists collectively of investment income and income from the rendering of personal service; and

(iii) such company is not an employment company.

The whole area of taxation of small businesses is constantly under review. A new innovation introduced in 2008 allows micro businesses to opt for a simplified turnover tax basis, under which there is no liability for the first R150 000, and 7,0% on turnover above R750 000 per annum (2011/2012 tax tables).

Secondary tax on companies (STC) at 10% on dividends declared is paid as a withholding tax on all dividends paid.

A withholding tax is the amount of an employees pay withheld by the employer and sent directly to the government as partial payment of income tax.

2.12.4 TAXATION OF RETIREMENT FUNDS

The Pension Funds Act and the Income Tax Act make provision for the recognition of a number of different types of funds which are designed to give benefits on retirement, death or ill health to members and/or their dependants.

However, once approved under these Acts there are certain conditions with which the funds must comply and these are set out in the attached tables later in this chapter.

These conditions are considered to be the most relevant and, accordingly, the following notes are intended to give the additional background and explanation not included in the tables themselves which of necessity must be brief for easy reference.

Eligibility

In the case of Pension and Provident Funds, membership of the scheme is compulsory for all new employees who are eligible in terms of the Rules of the fund. For example, the Rules may allow for salaried employees to be members but not hourly paid employees. This is what is meant by stated categories of employees.

Benefit Description

This may be either **defined benefit** and fixed or **defined contribution**. The benefits in a defined benefit fund are based on salary and service, whereas a defined contribution base the benefits on contributions and bonuses. In this context bonuses mean any amounts added to the contributions by way of interest.

Cash option at retirement

Note the main difference between a pension and a provident fund, is that under a pension fund only one-third of the retirement benefit may be taken as a cash lump sum, the balance must be a pension, whereas the full benefit may be taken in cash from a provident fund.

Tax Deductibility

(a) Employer contributions

Although the Income Tax Act states that the employer is entitled to deduct an amount equal to 10% of his wage bill from his taxable income, in practise the authorities allow up to 20%. Note that the allowance covers all types of funds including medical aid schemes.

(b) Employee contributions

The words retirement funding employment mean employment which includes membership of a pension or a provident fund.

Where the employee is a member of a pension and/or a provident fund the implications for the deductions of contributions to a retirement annuity fund must not be overlooked.

Note in terms of the gender equality practised in South Africa in accordance with the new constitution there is no longer any distinction allowed between men or women. A married woman is entitled to claim the same deductions as her husband if she is a wage earner in her own right.

Tax-free portion of any amounts that can be taken as a cash lump sum at retirement

In the past, the tax free portion of the lump sum was calculated using a formula based on years of membership of a fund, with certain maxima applying according to the Second Schedule of the Income Tax Act.

As from October 2007 the system has been simplified considerably, and the basis is as follows:

Taxable Income (R)	Rate of Tax (R)
0 - 315 000	0% of taxable income
315 001 - 630 000	18% of taxable income above 315 000
630 001 - 945 000	56 700 + 27% of taxable income above 630 000
945 001 and above	141 750 + 36% of taxable income above 945 000

Since the situation of death and disability are treated as if retirement had occurred on the day before, this will also apply to benefits on death or disability before retirement.

A change in the tax formulas in the Second Schedule allows for the special concession to certain government employees in terms of which the full benefits secured prior to 1998 could be taken as a tax free lump sum.

Special retrenchment concession

Another concession introduced in 2009 was to allow lump sum benefits paid on retrenchment to be treated as if they were retirement benefits.

Withdrawal from a fund

Where a taxpayer withdraws from a fund, either as a result of resignation from the fund, or due to the fact that the fund is wound up, the proceeds of the fund payable to the member will be taxable. It is, however, possible for the taxpayer to eliminate the tax implications on the money due to him if the money is re-invested in one of the following ways by transferring any amount received by the taxpayer from:

(a) an approved pension fund into another approved pension or a retirement annuity fund. This would also include transfer to an approved pension preservation fund;

(b) an approved provident fund into another approved provident, pension or retirement annuity fund. This would also include transfer to an approved pension or provident preservation fund;

(c) a retirement annuity fund to another retirement annuity fund.

These are set out in paragraph 6 of the Second Schedule. Should the taxpayer not choose to transfer the money as explained above then the first R1 800 received by him was tax exempt. However, this has since been changed and the tax treatment of withdrawals has been brought more in line with that on retirement lump sums, as outlined below.

Automatic taxation of withdrawal benefits

As from 1 March 2009 if a person resigns, his resignation benefit does not have to be moved to another retirement fund within 6 months. There is no longer any time frame within which the member has to move his resignation benefit. The date for accrual, for tax purposes, will be the date that the member elects to have the benefit paid to him, or moved to another fund.

Rate of taxation of withdrawal benefits

Taxable Income (R)	Rate of Tax (R)
0 - 22 500	0% of taxable income
22 501 - 600 000	18% of taxable income above 22 500
600 001 - 900 000	103 950 + 27% of taxable income above 600 000
900 001 and above	184 950 + 36% of taxable income above 900 000

Application

Note that these amounts are accumulative across all funds including retirement annuity funds and not per withdrawal. What's more, the concessions on withdrawal, including retrenchment, impact on the eventual allowance at retirement.

As an **example**, consider the following.

A person retires on December 30, 2010 and receives a lump sum of R950 000. He previously resigned from a pension fund on June 1, 2009 and withdrew a lump sum of R300 000. The tax on the R300 000 was calculated as follows:

R22 500 is tax free

R300 000 - R22 500 = R277 500

18% of R277 500 = R49 950

When he retires, his tax is calculated as follows:

R950 000 (retirement lump sum taken in 2010) + R300 000 (withdrawal lump sum taken in 2009) = R1 250 000

Tax on R1 250 000 according to retirement tax tables:

R135 000 + 36% of R350 000 (R1 250 000 - R900 000)
=R135 000 +R126 000
=R261 000

Notational tax on R300 000 = R0

Tax on lump sum = R261 000

The Tax on Retirement Funds Act

The Tax on Retirement Funds Act of 1996 (Act no. 38 of 1996) was put in place in order to provide for the taxation of the interest and rental income earned by retirement funds, and the untaxed policyholder funds of long term insurers, on an interim basis pending the outcome of discussions on the taxation of retirement savings in general. Rental income was later expanded to also include any dividends distributed by a fixed property company as defined in the Collective Investment Schemes Act, commonly known as property trusts or property unit trusts.

Retirement fund means any pension, provident or retirement annuity fund approved for the purposes of the Income Tax Act by the Registrar of Pension Funds and the Commissioner of the South African Revenue Services, and includes any funds administered by a long term insurer.

Profit in the fund (that is, after certain deductions have been made against the interest and rental income earned by the fund), is taxed at a flat rate, which varied considerably over time. At one stage reaching a high of 25% before being reduced to 9% *and then* set at zero in October 2007. The debate as to the taxation of funds still continues.

The tax treatment of approved funds

In order to promote retirement savings, the Government has applied a favourable tax basis on approved retirement plans. The effect of this can be seen in the table below.

Type of policy	Retirement annuities	Pension funds	Provident funds
Administrative requirements	Must be approved by the Registrar of Pension Funds Act Must be approved by the Commissioner for SARS Membership agreement between employer / employee Fund must be registered	Must be approved by the Registrar of Pension Funds Act Must be approved by the Commissioner for SARS Membership agreement between employer / employee Fund must be registered	Must be approved by the Registrar of Pension Funds Act Must be approved by the Commissioner for SARS Membership agreement between employer / employee Fund must be registered

Type of policy	Retirement annuities	Pension funds	Provident funds
Member contributions	Contributions are tax deductible subject to a limit of the greater of: A 15% of non-retirement funding income (subject to some deductions) OR B R3 500 less the value of deductible contributions paid to a pension fund OR C R1 750	Contributions are tax deductible subject to a limit of the greater of: 7,5% of income OR R1 750	No tax deductions allowed for members
Employer contributions	No employer contributions are made	10% of approved remuneration for pension, provident and medical aid schemes. In practice, up to 20% is allowed, higher limits will be allowed, if justified	10% of approved remuneration for pension, provident and medical aid schemes. In practice, up to 20% is allowed, higher limits will be allowed, if justified
Arrear contributions	R1 800 deductible p.a. deduction per person	R1 800 deductible p.a. deduction per person	Not tax deductible
Proceeds	Only $^{1}/_{3}{}^{rd}$ of the proceeds may be taken as a lump sum unless the total is less than R75 000. The balance must be used to purchase an annuity which will be taxed as normal income in the hands of the recipient.	Only $^{1}/_{3}{}^{rd}$ of the proceeds may be taken as a lump sum unless the total is less than R75 000. The balance must be used to purchase an annuity which will be taxed as normal income in the hands of the recipient.	The full proceeds may be taken as a single lump sum.
Tax on proceeds	In 2007 the approach to taxing the proceeds was vastly simplified. All proceeds are accumulated and the following tax concessions apply: First R300 000 tax free Next R300 000 taxed at 18% Further R300 000 taxed at 27% Thereafter taxed at 36%	In 2007 the approach to taxing the proceeds was vastly simplified. All proceeds are accumulated and the following tax concessions apply: First R300 000 tax free Next R300 000 taxed at 18% Further R300 000 taxed at 27% Thereafter taxed at 36%	In 2007 the approach to taxing the proceeds was vastly simplified. All proceeds are accumulated and the following tax concessions apply: First R300 000 tax free Next R300 000 taxed at 18% Further R300 000 taxed at 27% Thereafter taxed at 36%

Type of policy	Retirement annuities	Pension funds	Provident funds
Investment growth	Although the funds are held in what is known as the insurer's tax free portfolio the Tax on Retirement Funds Act has meant that some tax was levied on the growth but the rate was reduced to zero during 2007.	Although the funds are held in what is known as the insurer's tax free portfolio the Tax on Retirement Funds Act has meant that some tax was levied on the growth but the rate was reduced to zero during 2007.	Although the funds are held in what is known as the insurer's tax free portfolio the Tax on Retirement Funds Act has meant that some tax was levied on the growth but the rate was reduced to zero during 2007.
Annuity	Compulsory purchase - taxable in full. Voluntary purchase - capital element tax free.	Compulsory purchase - taxable in full. Voluntary purchase - capital portion tax free.	All voluntary purchase - capital element tax free.
Eligibility	Voluntary. Individual contract between member and the fund	Compulsory for stated categories	As for pension funds
Benefit description	Pension based on contributions and bonuses	Pension based on: (a) Salary and service OR (b) contribution and bonuses	Lump sum or pension based on: (a) Salary and service OR (b) contribution and bonuses
Retirement ages	Must be after age 55	Fixed in accordance with rules	As for pension funds

2.12.5 AVERAGE AND MARGINAL TAX RATES

(a) Average rates

The average rate of tax is calculated by dividing the assessed amount of tax by the total taxable income:

$$\frac{\text{Tax due before rebates}}{\text{Taxable income}} \times 100 = \text{Average tax rate}$$

As from 1 September 1995 the average rate applicable is taken as the **higher** of the average rate in the year of retirement and the previous year. This was introduced to prevent the practise of planning one's financial affairs so as to severely reduce the average rate applicable in the year of retirement.

(b) Marginal rates

This is the rate of tax which applies to every additional R1 of income. It is suggested that you refer to a table of tax rates where you will see that the percentage rate of tax increases as the taxable income increases.

As from 2009 the following amendments came into effect.

- ***Retirement from a retirement annuity fund***

  The maximum age of 70 was removed and membership of a fund is now allowed until ceasing employment.

- ***Surrendered RAs***

  If an RA is made paid up and the value is less than R7 000 the member can withdraw the full amount, which will be taxed as a withdrawal. The abovementioned rules regarding the tax treatment will apply.

- ***Emigration and RAs***

  If a member of a RA fund is planning to emigrate, he will be entitled to withdraw the fund value of his RA if the following is adhered to-

  - the RA must be made paid up prior to emigration; and
  - the emigration must be recognised by the SARB.

  This applies to emigration prior to retirement and the withdrawal amount will be taxed in terms of the new proposals. The amount that the member will receive will form part of his normal emigration allowance.

  The remittance of the funds offshore in light of the emigration will form part of the foreign capital allowance, which is currently R2 million for individuals and R4 million for a family unit (as at mid-2009). This is not available to a person if he/she has already reached the normal retirement age.

  (Consideration is also being given to including retirement annuity contributions paid by the employer on behalf of an employee with in the tax deduction parameters for pension funds.)

2.12.6 TAXATION OF LIFE INSURANCE POLICIES

With the phasing out of the Sixth Schedule of the Income Tax Act the taxation of ordinary life policies has been greatly simplified. Apart from the tax on the fund build up in the insurer's hands there are no tax implications on the proceeds of life policies held by natural individuals.

Where a policy is held by a company one of two situations may apply

(i) the company could pay the premium out of after-tax income (i.e. not deduct the premiums from corporate taxable income) in which case the proceeds would be paid out tax free; or

(ii) the company could deduct the premiums from taxable income in which case the proceeds would be taxable in the company's hands.

The tax deductible premium facility only applies to certain policies, commonly called approved or regulation policies because they comply with the requirements laid down for approval of tax deduction by the Minister of Finance under Section 11(w) of the Income Tax Act.

2.12.7 DONATIONS TAX

Donations tax is levied at a flat rate of 20% on gifts to another person or organisation at any time during one's life (down from 25% before the introduction of CGT). Various exemptions are provided for, the most important of which are donations to spouses, donations of up to R100 000 per annum in total by a natural person, donations where no benefit arises until the death of the donor, donations to certain institutions and property disposed of by a trust to its beneficiaries.

2.12.8 CAPITAL GAINS TAX (CGT)

The following is a brief summary of the capital gains tax introduced into the South African tax structure from October 2001. Details of CGT have been included into the Income Tax Act as an Eighth Schedule to the Act.

- Residents are subject to the tax on the disposal of their assets held worldwide, while non-residents are taxed on certain assets in South Africa.

- Capital gains tax will not apply to retirement funds until a holistic review of retirement fund taxation is complete.

- Assets include property of whatever nature, whether movable or immovable, corporeal or incorporeal.

- Gains accruing after 1 October 2001 are subject to the tax, which will be levied on a realisation basis. Realisation occurs on disposal of an asset. Death, emigration and the donation of an asset are deemed to be disposals.

- The first R20 000 a year of capital gain or loss realised by individuals is excluded. Where a person dies during the year of assessment, that person's annual exclusion for that year is R200 000.

- Certain exemptions apply to primary residences, gains of up to R1,5 million or where the total proceeds are under R2 million, personal use assets, insurance and retirement benefits, assets of a small business disposed of for retirement, compensation for personal injury, lottery receipts, foreign currency converted for personal use, diplomats and diplomatic missions, gains arising on assets donated to certain public-benefit organisations.

- Capital gains are taxed with other income, with a portion of the net capital gain being included in taxable income, depending on the nature of the taxpayer.

2.13 POLICYHOLDER PROTECTION RULES

The original policyholder protection rules which came into effect in 2001 were introduced with far more detail than was originally intended. This was due to the delays in implementing the Financial Advisory and Intermediary Services Act (FAIS) and was always considered to be only a temporary measure until that was promulgated. Once this occurred, the Policyholder Protection Rules (PPR) needed to be changed. The revised Policyholder Protection Rules came into force in 2004. The new version of the rules replaced the old rules in their entirety.

The main change to the PPR was the moving of the disclosure requirements of providers other than direct marketers, including the compulsory disclosure document, under the FAIS General Code of Conduct.

The disclosure rules for Direct Marketers still exist under the PPR.

The objective of the PPR is to ensure that insurance contracts are entered into, executed and enforced in accordance with sound insurance principles and practice and are in the interests of all the parties involved, as well as the public interest, if applicable. These rules cannot, in any way, affect or change the duty of any person in terms of FAIS legislation or requirements.

In the Rules, the Act means either the Short Term Insurance Act or the Long Term Insurance Act, including the Regulations promulgated thereunder, while the FAIS Act means the Financial Advisory and Intermediary Services.

2.13.1 BASIC RULES FOR DIRECT MARKETERS

The Policyholder Protection Rules (effective from 30 October 2004) contain a comprehensive set of rules that must be followed by direct marketers regarding aspects such as:

- making contact with prospects;
- the representations (statements made) to the prospect;
- procedures and systems for record-keeping; and
- disclosures that need to be made.

A direct marketer is an insurer who undertakes business in the form of direct marketing.

Direct marketing is the marketing of insurance by way of, telephone, internet, media insert, or direct or electronic mail, but excludes any communication that falls under the description of advertising.

A direct marketer must at all times render service honestly, fairly, and with due skill, care and diligence. In making any contact arrangements, and in all communication and dealings with a policyholder a direct marketer must act honourably, professionally, and with due regard to the convenience of the prospective client.

Where any representation is made or information is provided to a policyholder it must be factually correct, provided in plain language, avoid uncertainty or confusion and not be misleading and be adequate and appropriate in the circumstances of the relevant marketing, taking into account the level of knowledge of the policyholder.

Direct marketers must have facilities available to record and store all verbal (voice-logging) and written communications between itself and its policyholders and must keep these records for at least five years after the termination of the contract with the policyholder.

2.13.2 CANCELLATION OF A POLICY BY THE INSURED

Where a policyholder has not yet received a benefit or instituted a claim against a policy he may cancel the policy within 30 days and the insurer must, no later than 60 days after having received the notice of cancellation, refund to the policyholder any premiums, that it may have received. The only costs that may be deducted from the refund amount are those related directly to the provision of any risk benefits that the policyholder may have enjoyed before the cancellation.

2.13.3 OTHER RULES AND DUTIES

1. The Policyholder Protection Rules address the issue of void provisions on policies, effectively barring insurers from refusing claims on the basis of:

   - polygraph tests;
   - requiring arbitration for disputes; and
   - enforcing the period of grace for premium payments.

2. Contact details of the relevant Ombud's office need to be supplied.

3. An insurer must ensure that, where it rejects or disputes a claim, the policyholder is notified in writing of the reasons therefore and must be granted not less than 90 days to make representation to the insurer regarding its decision.

4. No insurer or intermediary may allow a policyholder to sign a blank or partially completed application form for insurance.

5. Whenever an insurer agrees to a policy loan it must inform the policyholder of;

   - the interest he will be paying at the time that the loan is entered into;
   - whether the interest rate will fluctuate; and
   - what the repayment arrangements are.

The insurer must also disclose to the policyholder -

- the amount of the policy loan and accrued interest in relation to the value of the policy on a quarterly basis;
- the interest rate applicable to the policy loan and any changes thereto - also on a quarterly basis;
- when the loan is about to equal the value of the policy;
- when the benefits under the policy cease as a result of the policy loan equalling the value of the policy.

6. On receipt of notification of a cession the insurer must disclose to the policyholder that the cession is recorded in the insurer's records, the nature of the cession and the name of the cessionary.

7. No insurer or intermediary may ask or induce a policyholder to waiver any of his rights or benefits conferred on the policyholder by the terms and conditions of these rules.

Complaints Process

An insurer must, within a reasonable time after the issue of a policy or the commencement date thereof, inform the policyholder in writing of the details of any internal dispute resolutions systems and procedures that it has in place. The insurer must also, at the same time, provide the policyholder with the full particulars of the Long Term Insurance Ombudsman.

2.13.4 ASSISTANCE BUSINESS GROUP SCHEMES

An **assistance business group scheme** means the provision of policy benefits under an assistance policy to a group where -

(a) individual persons are the policyholders;

(b) no individual underwriting takes place;

(c) the individual person whose life is insured, is directly or indirectly paying premiums;

(d) the policy may be cancelled by either party to the policy; and

(e) the policy has term cover only.

It is normal practice that policies of this nature are administered by a licensed financial service provider (FSP), which has a written mandate from an insurer to do the administration of the scheme. The FSP will handle:

- all enquiries;
- maintain administrative records;

- receipt premiums; and
- process claims,

in accordance with the mandate which will be clearly stipulated in the agreement by the underwriting insurer.

The agreement entered into must contain at least the following clauses -

(a) the premium rates to be charged by the insurer inclusive of commission payable by the insurer to an intermediary involved;

(b) any fees to be added by any other party;

(c) if premiums are to be received by any person other than the insurer, the agreement must contain at least the following:
   (i) the period within which such premiums will be paid over to the insurer;
   (ii) that the insurer has the authority to at any time audit the books of the person receiving the premium;
   (iii) that the premium moneys so received are handled as trust money;

(d) the scheme or administrator must provide the insurer with at least the following detail:
   (i) names of policyholders and beneficiaries; and
   (ii) identity numbers of policyholders.

If the scheme or administrator has the authority to pay claims, it must set out the scope of the scheme's or administrator's powers to do so, and the circumstances under which it may be done. The agreement cannot be cancelled by either party, unless another insurer has provided written confirmation that it will take over the scheme.

Alternatively the original insurer must provide the new insurer with all the relevant information regarding the scheme within 30 days of receiving confirmation that the insurer is prepared to consider the scheme.

The new insurer must then, also within 30 days of having accepted the liability of the scheme, comply with all disclosure requirements by virtue of any legislation, including the FAIS Act. The new insurer is not allowed to impose any new waiting period to any existing policyholders on the scheme. A cancellation of an agreement to do so, will only be effective if the Registrar had been informed of the cancellation before it happens, and is satisfied that all existing policyholders have been notified of the cancellation.

2.13.5 OTHER REQUIREMENTS OF THE POLICYHOLDER PROTECTION RULES

Termination

Where a policyholder has not yet received a benefit or instituted a claim against a policy he may cancel the policy within a period of 30 days following the receipt by him of the summary that must be provided by the insurer in terms of Section 48 of the Long Term Insurance Act. The insurer must, not later than 60 days after having received the notice of cancellation, refund to the policyholder any premiums that it may have received. The only costs that may be deducted from the refund amount are those related directly to the provision of any risk benefits that the policyholder may have enjoyed before the cancellation.

Policy Documents

An insurer must provide the principal officer, trustees or managing person of a fund with a printed policy document for any fund policies that it may underwrite. It is only where the insurer has obtained the approval of the Registrar that this delivery may be postponed. The document must include all the conditions relating to discontinuance as well as a clear indication of all financial arrangements. This includes full details of all charges to be levied if the policy is terminated.

2.14 THE FINANCIAL INTELLIGENCE CENTRE ACT

The introduction of this Act states as its objectives:

> To establish a Financial Intelligence Centre and a Counter-Money Laundering Advisory Council in order to combat money laundering activities:
>
> - to impose certain duties on institutions and other persons who might be used for money laundering purposes;
> - to amend the Prevention of Organised Crime Act, 1998, and the Promotion of Access to Information Act, 2001; and
> - to provide for matters connected therewith.

The FIC Act defines that certain organisations should be registered as an accountable institution. These definitions include:

- a person who carries on long term insurance business as defined in the Long Term Insurance Act; and
- a person who carries on the business of a financial services provider requiring authorisation in terms of the Financial Advisory and Intermediary Services Act, 2002, to provide advice and intermediary services in respect of the investment of any financial product, but excluding short term insurance and health service benefits.

The Act imposed certain reporting and record-keeping duties on accountable institutions which need to be complied with.

QUESTIONS ON CHAPTER 2

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Mental revision questions

Work through these mental revision questions as a test of your understanding of this chapter. We suggest that you attempt these before tackling the written questions. Please note that suggested answers are not provided as the chapter's text contains the answers.

1. List the types of people who have no contractual capacity.

2. When must insurable interest be present:
   2.1 on a short term contract;
   2.2 on a life contract?

3. Explain what conditional selling is and explain the Long Term's Insurance Act's methods of dealing therewith.

4. Name three of the more common types of absolute cessions.

Written questions

Attempt these questions after you have completed this chapter and its mental revision questions. Suggested answers to these questions are at the end of this book.

1. Give five examples of insurable interest and briefly explain each one.

2. Explain what is meant by the reasonable man test.

3. Give six of the restrictions applicable to any new policies that are now issued in accordance with Part 4 of the Regulations to the Long Term Insurance Act and briefly explain each one.

4. Explain the duties of the trustees where the nominated beneficiary on the deceased's retirement annuity contract is not a dependant.

5. What conditions need to be met in order that an employee may claim the first R30 000 of a gratuity paid to him by an employer as a tax exempt amount?