

BINDING PRIVATE RULING: BPR 359

DATE: 16 March 2021

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITION OF “GROSS INCOME”, 11(a), 23(g) AND 28
SUBJECT : TRANSFER OF REINSURANCE BUSINESS FROM A RESIDENT COMPANY TO A LOCAL BRANCH OF A FOREIGN COMPANY

Preamble

This binding private ruling is published with the consent of the applicant(s) to which it has been issued. It is binding between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing.

1. Summary

This ruling determines the tax consequences, for a resident company that conducted reinsurance business, of the transfer of its business as a going concern to a local branch of the foreign holding company of the Applicant.

2. Relevant tax laws

In this ruling references to sections are to sections of the Act applicable as at 25 February 2021. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of –

- section 1(1) – definition of “gross income”;
- section 11(a) read with 23(g); and
- section 28.

3. Parties to the proposed transaction

The Applicant: A resident public company that is a wholly-owned subsidiary of a foreign company

The Co-applicant: A foreign company acting through a permanent establishment registered as an external company in South Africa

4. Description of the proposed transaction

It recently became lawful for a non-resident reinsurer to operate via a branch in South Africa. The Applicant proposes to transfer its reinsurance businesses to the Co-applicant once a branch license has been granted to the Co-applicant by the

Prudential Authority. After the transfer of the reinsurance businesses the activities of the Co-applicant will be identical to the former activities of the Applicant.

The proposed steps to implement the transfer are as follows:

- The Applicant will, as step 1a, transfer its existing short-term reinsurance business to the Co-applicant. This will comprise the payment of a cash amount by the Applicant in exchange for the assumption by the Co-applicant of the net underlying liabilities owing to short-term reinsurance policyholders. The consideration is viewed by the Applicant as the arm's length market value of the short-term reinsurance business. Any residual value of the short-term business will then be distributed in cash by the Applicant to its non-resident shareholder as a liquidation dividend, subject to any obligation to withhold dividends tax.
- The Applicant will, as step 1b, transfer its existing long-term reinsurance business to the Co-applicant. The Applicant will pay a cash amount in exchange for the assumption by the Co-applicant of the Applicant's liabilities owing to its long-term reinsurance policyholders. The consideration is viewed by the Applicant as the arm's length market value of the long-term reinsurance business. Any remaining policyholder assets will be transferred to the Corporate Fund under section 29A and taxed there. Any residual value that remains of the long-term business will be distributed in cash as a liquidation dividend to the Applicant's non-resident shareholder, subject to any obligation to withhold dividends tax.
- The Applicant will, as step 1c, transfer its reinsurance goodwill (comprising, amongst others, goodwill, renewal rights and customer lists) to the Co-applicant for a market-related cash consideration. The Applicant may decide to set off its obligation to pay the cash amount under Step 1b against the Co-applicant's obligation to pay the cash consideration under Step 1c.
- As step 2, the Co-applicant will be required to transfer cash to a South African trust, formed to provide and maintain local security for policyholders. The Co-applicant will be the vested income beneficiary of the trust. Policyholders will have rights against the trustees in respect of the trust assets. The trustees will settle qualifying claims directly with policyholders. Quarterly, the assets of the trust will be reconciled with the value of the liabilities covered by the trust assets. Whenever a surplus arises, this amount will vest in the Co-applicant. Similarly, upon termination of the trust, any surplus assets will vest in the Co-applicant.
- In step 3, in a separate but simultaneous transaction from the transfer of the insurance liabilities in steps 1a and b, the Applicant will transfer office equipment and other property it has the right to use, as well as accounts receivable from assumed reinsurance transactions and other assets, the liability under a lease, as well as accounts payable under assumed and ceded reinsurance transactions, provisions and other liabilities, to the Co-applicant. In consideration for the sale of the assets in step 3, the Co-applicant will assume liabilities (other than the policyholder liabilities) and pay a cash consideration.
- Subsequent to the proposed transaction the Applicant will be liquidated and deregistered.

5. Conditions and assumptions

This binding private ruling is subject to the following conditions and assumptions:

- a) The pricing of the delegation payments under step 1a and step 1b is market-related.
- b) The Co-applicant will constitute a permanent establishment in South Africa.

6. Ruling

The ruling made in connection with the proposed transaction is as follows:

- a) The delegation payment in step 1a in relation to the transfer of the net short-term policyholder liabilities to the Co-applicant is not deductible by the Applicant.
- b) The receipt of the delegation payment in step 1a by the Co-applicant will not constitute "gross income" as defined in section 1(1).
- c) The receipt of the delegation payment in step 1b by the Co-applicant will not constitute "gross income" as defined in section 1(1).
- d) The Co-applicant may apply section 28(3) and (4) in relation to its short-term insurance business and section 28(3A) in relation to the long-term insurance business.
- e) The Co-applicant may not deduct the contribution to the South African trust in step 2.
- f) The receipts from the South African trust (excluding any investment income thereon) will not constitute "gross income" as defined in section 1(1) for the Co-applicant.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five years from 25 February 2021.