Tax treatment of insurance claims arising from the July riots

TAX ALERT – FEBRUARY 2022

KwaZulu-Natal and parts of Gauteng were severely affected by the unrest in July 2021 with many businesses seriously impacted or completely destroyed. Whilst insurance claims are still being finalised there may be some who have received such insurance proceeds and are unsure as to how to treat this income for tax purposes.

Income Tax

With most companies' provisional tax being due on 28 February 2022, it is imperative that consideration be given to this to ensure that your provisional tax estimate is accurate.

In terms of paragraph 65 of the Eight Schedule to the Income Tax which deals with "involuntary disposals", where movable or immovable assets are disposed of by way of operation of law, theft or destruction, taxpayers can defer taxable recoupments and capital gains.

This deferral is available provided the following requirements are met:

- the proceeds are equal to or exceed the base cost
- the proceeds are fully reinvested in replacement assets
- the replacement assets must be contracted for within 12 months
- the replacement assets must be brought into use within three years.

These abovementioned periods can be extended up to 6 months upon an application being made to the South African Revenue Service (SARS).

The tax on the recoupment and capital gain upon the disposal of the old asset which would otherwise have arisen in the current tax year is spread over future tax years in accordance with the wear and tear which will be claimed on the replacement asset/s. Where more than one replacement asset is acquired the recoupment and capital gain is apportioned according the to the cost of the replacement assets. It is important to note that personal assets do not qualify for this relief.

This deferral and spreading of the recoupment and capital gain may have a significant effect on the determination of your taxable income for the purposes of provisional tax and the final taxable income upon submission of the return for the 2022 tax year.

Value Added Tax (VAT)

An insurance pay-out is regarded as a deemed supply of goods in terms of section 8(8) of the Value-Added Tax Act (VAT Act). Accordingly, output tax is payable on the insurance pay-out.

For example: where a company receives an insurance pay-out of R50,000 for an item of equipment that was stolen or damaged the output tax is determined as R6,521.74 (i.e., R50,000 x 15/115).

No output tax is payable where-

- an input tax deduction was denied for the asset (for example, a "motor car");
- The insurance pay-out is in respect of long-term insurance; or
- The insurer replaces the damaged or stolen goods.

It is recommended that the utmost care be taken to ensure the correct Income Tax and VAT treatment of these insurance pay-outs. Should you require assistance, please contact your nearest PKF office.

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Should you have any queries on these matters, please contact your PKF relationship partner or firm.

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