A CRITICAL ANALYSIS OF THE TAX CONCESSIONS RELATING TO MEDICAL EXPENSES, WITH PARTICULAR EMPHASIS ON PERSONS WITH A PHYSICAL IMPAIRMENT OR DISABILITY

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Abstract

This thesis provides a critical analysis of the tax concessions granted in respect of medical costs, with particular reference to persons with a physical impairment or "disability" in the South African context. The primary method of collecting information for this research was through an extensive analysis of the South African legislation that is specifically applicable to a person who has a physical impairment or a "disability". The analysis placed particular emphasis on the qualifying diagnosis criteria for a "disability" as defined for tax purposes as well as on the qualifying expenditure incurred in consequence of a person's physical impairment or "disability". A further goal of the research was to analyse the specific provisions of the Income Tax Act that are applicable to a special trust created for the benefit of a person with a physical impairment or "disability". This research also includes a brief evaluation of the extent to which medical schemes provide coverage for non-discretionary expenditure items incurred in consequence of a person's "disability" and whether this differs from the qualifying expenditure in terms of the Income Tax Act. It is important to conduct research of this nature in order to identify areas where the legislation could be improved. Accordingly, the thesis also recommends possible amendments to the current provisions of the legislation that are specifically applicable to persons with a physical impairment or "disability".

Keywords:

disability; medical expenses; physical impairment; special trusts; taxation

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Chapter One: Introduction

1.1 Context

Rooted in the Preamble to the Constitution of the Republic of South Africa, 1996 (referred to as "the Constitution"), is the notion that the Constitution is adopted as the supreme law of South Africa in order to realise certain ideals, including the equal protection of every citizen by law, improving the quality of life of all citizens and freeing the potential of each person. In terms of paragraph (a) of section 1 of the Constitution, South Africa is a state founded on the values of human dignity, the achievement of equality and the advancement of human rights and freedoms. Section 2 of the Constitution establishes that any law of South Africa that is inconsistent with it is invalid. The Bill of Rights is established in Section 7 of the Constitution and, in terms of that section, the state must respect, protect, promote and fulfil the rights contained in the Bill of Rights. Section 9(2) of the Constitution provides for legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination. Section 9(3) of the Constitution provides that the state may not unfairly discriminate directly or indirectly against anyone on the grounds of, *inter alia*, a person's disability. In terms of section 9(4) of the Constitution national legislation must be enacted to prevent or prohibit unfair discrimination. It should be noted that section 9 of the Constitution forms part of the Bill of Rights. When interpreting any legislation, in terms of section 39(2) of the Constitution, any court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights. It is clear that, deeply enshrined in the Constitution, is the protection of persons with disabilities from unfair discrimination and an acknowledgement that legislation may be necessary to protect or advance persons who are disadvantaged by unfair discrimination. Furthermore, no law may unfairly discriminate on the grounds of a person's disability and when interpreting any law, the spirit of this non-discrimination must be applied. Accordingly, all tax legislation must take into account any unfair disadvantage that a person with a disability might have and the legislature is empowered to enact laws which protect or advance persons who are disadvantaged by unfair discrimination.

In his foreword to the Integrated National Disability Strategy White Paper which was published in November of 1997, then Deputy President of South Africa, Thabo Mbeki,

remarked that a society's respect for human rights, its level of maturity and its generosity of spirit can be measured and evaluated by judging the status that it accords to those members of society who are, *inter alia*, disabled people (Government of the Republic of South Africa: 1997). In November of 2000, Trevor Manuel, then Minister of Finance, in reply to a question in the National Assembly, emphasised that the government has tried to support disabled members of society financially on both the tax and expenditure sides of the fiscal budget (Government of the Republic of South Africa: 2000). Whilst the social assistance afforded to disabled people by way of welfare grants and government support of non-profit organisations is not within the context of the present research, the financial relief offered to the disabled community by way of tax concessions to which Trevor Manuel refers is the key focus of this thesis. Steenkamp (2011) questions whether the people who stand to benefit from the relevant tax relief are aware that their disability-related expenses are fully deductible [as they were prior to the 2015 year of assessment] for tax purposes. The most recently published tax statistics relate to the tax periods 2010 to 2013 and reflect that for the 2013 year of assessment only 0.85 per cent of assessed taxpayers declared that they, their spouse, their child, or any other dependant had a "disability" (SARS: 2014a). This statistic translates to 44 033 taxpayers. According to the 2011 Census, 51 770 560 people live in the country (Statistics South Africa: 2012). The same Census indicated that 6.2 per cent of South Africans (approximately 3.2 million people) experience moderate to severe difficulty in seeing, hearing, communicating, walking or climbing stairs, remembering or concentrating, or self-care. To avoid obscuring the results of the Census, the questions about these difficulties were only applicable to people aged 5 and older. If people who experience *mild* difficulty in engaging in these activities are also taken into account, the number of people who could potentially be regarded as having a physical impairment or "disability" for income tax purposes escalates to approximately 14.2 million people, 27.5 per cent of the population. It is statistics such as these to which disability tax specialist, Bendel (2010, in Moneyweb Tax: Online) refers when he states that the number of people claiming the relevant available tax concessions "*distressingly bears no correlation to the reality of the number of people who suffered from a disability*".

It has been acknowledged that there is "*serious lack of reliable information on the nature and prevalence of disability in South Africa*" (Government of the Republic of South Africa, 1997: Online). Speculation on the prevalence of physical disabilities falls outside the scope of the thesis, however. The two possible reasons for the poor uptake of the available tax relief are:

a lack of awareness of the existence of the tax relief, which is also not addressed in the present research, and problems inherent in the relevant tax legislation that could prevent the intended persons from qualifying for the envisaged relief. It is the latter concern that forms the focus of the thesis.

Two tax concessions are granted to taxpayers in respect of medical expenses. These are tax rebates (sometimes referred to as tax credits) provided for in sections 6A and 6B of the Income Tax Act 58 of 1962 (referred to as "the Income Tax Act") in terms of which deductions are made from the taxpayer's tax liability. The recent transition to affording taxpayers a tax credit instead of a tax deduction in respect of medical expenses is similar to the conversion undertaken by Canada during the 1980s (Steenkamp: 2011). Section 6A provides for a rebate in respect of medical scheme fees, up to standard maximum monthly amounts for the scheme member, his or her spouse and dependants. Taxpayers and their spouses or dependants who suffer from physical disabilities are subject to the same maxima and therefore enjoy no additional tax benefit. For years of assessment commencing on or after 1 March 2014, section 6B makes provision for an additional medical expenses tax credit in respect of medical scheme fees and specified medical expenses not recoverable from a medical scheme. It is this section that grants additional relief to taxpayers and their dependents who suffer from a physical impairment or "disability".

Section 6B(1) of the Income Tax Act (which replaces section 18 with effect from 1 March 2014) defines a "disability" as:

> a moderate to severe limitation of a person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation—
>
> a) has lasted or has a prognosis of lasting more than a year; and
>
> b) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner . . .

In this thesis, the word "disability" will be referred to in inverted commas when it is used with specific reference to its definition as contained in the Income Tax Act.

The Commissioner for the South African Revenue Service prescribes the criteria for a "disability" in terms of the *Confirmation of Diagnosis of Disability form (ITR-DD)* (SARS, 2014b:23). The provisions in this form and the implications it has for a person with a "disability" will be discussed in this research. The term "physical impairment" is not defined

in the Income Tax Act, but the South African Revenue Service (referred to as "SARS") (2014b:13) interprets it to mean "*a disability that is less restraining than a 'disability' as defined*". Accordingly, in the case of a physical impairment, the limitation placed on the person's ability to function or perform daily activities after maximum correction is less than "moderate to severe". In this context, "maximum correction" means "*appropriate therapy, medication and use of devices*" (SARS, 2014b:13).

Sub-paragraph (c) of the definition of "qualifying medical expenses" in section 6B(1) requires the diagnosis to be in accordance with criteria prescribed by the Commissioner and therefore the provisions in the form ITR-DD used by SARS carry significant evidential weight. The Commissioner has set out the prescribed qualifying expenditure in the *List of Qualifying Physical Impairment or Disability Expenditure* (SARS, 2014b:12). This research will include an analysis of this document and the implications it has for a person with a disability. A person might have an impairment which places a limitation on that person's ability to function or perform daily activities but such impairment might not satisfy a diagnosis which is in accordance with the criteria prescribed by the Commissioner and the related expenses incurred by the person may not qualify in terms of the list of qualifying expenses.

If a person's medical scheme does not provide coverage for a particular expense, the applicable tax legislation could be the only form of relief available to that person. In relation to any particular expense, the highest form of relief would be if the medical scheme covered that expense in full. If the medical scheme does not cover the full expense, the next level of relief would be partial coverage by the medical scheme and the balance could potentially be considered for tax relief. In a situation where the medical scheme does not cover the expense at all, the only form of relief available to the taxpayer is likely to be the potential tax relief. It should be noted that it is possible that a medical scheme could cover up to 100% of a particular expense, whereas the tax relief can only be up to 33.3% of the cost incurred; such tax relief can only be provided upon assessment of that person's tax return and the person will need to have paid the expense before he or she receives the relief.

It is possible for each person to plan their medical and tax affairs in a manner that ensures that he or she is receiving the maximum tax relief. For example, it is possible that a medical scheme with high premiums could cover more expenses, but if it is unlikely that that person will need that coverage then the increased premiums might not be warranted. The person

should compare the tax relief associated with their out-of-pocket medical expenses to the cost of increased premiums and the relief associated with those premiums to determine whether, in their unique circumstances, it would be better to incur more out-of-pocket medical expenses and lower premiums or higher premiums and lower out-of-pocket medical expenses. It is not guaranteed that higher premiums will result in lower out-of-pocket medical expenses as the type of expense that the person is incurring might not be covered by the increased-premium policy. It is important to compare the different types of expenditure that each form of relief is likely to be applicable to in order to aid this planning process. For example, if a medical scheme covers the cost of a child's personal attendant caregiver, such coverage could warrant increased premiums. If the medical scheme is not going to cover such expense, there could be tax relief available to the taxpayer. For each expense item, a person should consider whether they will receive partial or full medical scheme coverage and whether there is any tax relief in respect of that expense.

The Income Tax Act provides for a special trust which is created for the sole benefit of a person(s) with an incapacitating "disability". These special trusts enjoy favourable tax treatment when compared to ordinary trusts. Owing to the importance of receiving this preferential tax treatment, it is important for the founders and trustees of a trust created for the benefit of a person with an incapacitating "disability" to ensure that they have considered all the necessary legislative requirements when creating and managing such trust.

A taxpayer is reliant on the relevant tax concessions to ease the financial burden of non-discretionary out-of-pocket expenses associated with a physical impairment or disability. A person's physical impairment or disability could necessitate the incurrence of expenditure such as a personal attendant caregiver, special needs education, aids and devices, a service animal or adaptions to a home or vehicle. It is possible that the expenses recognised by the Commissioner for the purposes of the tax concession relating to disabilities may be more, or less, restrictive than the criteria prescribed by the various medical schemes. To gauge the importance of the tax concessions and the relief that they provide, it is necessary to evaluate the extent to which medical schemes provide coverage for non-discretionary expenditure items incurred in consequence of a person's disability and whether this differs from the qualifying expenditure in terms of the Income Tax Act.

1.2 Goals of the Research

The research questions that this research seeks to address relate to the tax concessions in respect of medical expenses, with particular emphasis on the tax legislation that is specifically applicable to persons who have a physical impairment or "disability". An analysis of the legislation aims to determine whether there is scope to recommend amendments. Further, to evaluate the importance of the applicable tax concessions, this research seeks to address the extent to which South African medical schemes provide coverage in respect of certain expenditure which is incurred in consequence of a person's physical impairment or disability, which may differ from the expenditure recognised by the Commissioner.

In order to address these issues, the goals of this research are:

- to analyse the South African tax legislation relating to medical expenses, with a particular emphasis on that which is specifically applicable to a person who has a physical impairment or a "disability";
- to analyse the definitions of and criteria for the recognition of a "disability" for tax purposes;
- to analyse the specific expenditure items that qualify for the additional rebate in terms of section 6B of the Income Tax Act in consequence of a person's physical impairment or "disability";
- to analyse the specific provisions of the Income Tax Act that are applicable to a special trust created for the benefit of a person with a physical impairment or "disability".
- to evaluate the extent to which medical schemes provide coverage for non-discretionary expenditure items incurred in consequence of a person's disability and whether this differs from the qualifying expenditure in terms of the Income Tax Act;
- to recommend possible amendments to the current provisions of the legislation that are specifically applicable to persons with a physical impairment or "disability".

1.3 Methods, procedures and techniques

An interpretative research approach will be adopted for the present research as it seeks to understand and describe (Babbie & Mouton: 2009). The research methodology to be applied in relation to analysing legislation and related documents can be described as a doctrinal research methodology. This methodology provides a systematic exposition of the rules governing a particular legal category (in the present case the legal rules relating to the tax relief in respect of medical expenditure incurred by natural person taxpayers), analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2014).

The documentary data to be used for the research consist of:

- legislation (with particular reference to sections 1, 6A and 6B of the South African Income Tax Act, No. 58 of 1962 and the repealed section 18 of that Act);
- SARS documents, including the *Guide on the Determination of Medical Tax Credits and Allowances*, the *List of Qualifying Physical Impairment or Disability Expenditure*, the *Confirmation of Diagnosis of Disability Form*, and the *Tax Statistics* for the year 2014;
- medical scheme rules and policy documents, in particular that of the largest medical scheme, Discovery Medical Scheme; and
- other writings.

The research is conducted in the form of an extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions will be ensured by:

- adhering to the rules of the statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent or which is of persuasive value (primary data) and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

With regard to the documentary data that is in the public domain, no ethical considerations arise in relation to their use.

1.4 Overview of chapters

Chapter One puts the research into context, sets out the research goals, describes the research methodology used, details the ethical considerations and provides an overview of the chapters.

Chapter Two provides a detailed critical analysis of the legislation that relates to medical expenses with a focus on the legislation that is specifically applicable to persons with a physical impairment or "disability". Particular emphasis is given to the diagnosis criteria for a "disability" as defined as well as the particular expenditure items incurred in consequence of a physical impairment or "disability" that may be taken into account for tax purposes. This chapter also discusses the provisions of the Income Tax Act which apply to special trusts created for the benefit of a person with a "disability".

Chapter Three examines and evaluates the extent to which medical schemes provide coverage in respect of the expenses incurred by a person in consequence of a physical impairment or disability. The role of this chapter is to highlight the importance of the tax relief that is specifically applicable to persons with a physical impairment or "disability".

Chapter Four provides a summary of the findings of this research, recommends amendments to the Income Tax Act, states the limitations of the present research and suggests opportunities for further research.

Chapter Two: Provisions of the Income Tax Act specifically applicable to persons with a physical impairment or "disability"

2.1 Introduction

This chapter commences with an analysis of the provisions of section 6A of the Income Tax Act. Section 6A provides for a medical scheme fees tax credit in respect of medical scheme contributions paid by a taxpayer. Accordingly, an analysis of this section of the Income Tax Act is included in pursuit of the goal of analysing the South African tax legislation that relates to medical expenses with a particular emphasis on the legislation that is specifically applicable to a person who has a physical impairment or a "disability". Following the section 6A discussion is a detailed analysis of section 6B of the Income Tax Act; this analysis has also been included as part of the goal of analysing the South African tax legislation that relates to medical expenses and the provisions that are specifically applicable to a person who has a physical impairment or a "disability". Section 6B provides for tax relief in respect of excess medical scheme contributions and qualifying medical expenses, including expenditure necessarily incurred in consequence of a physical impairment or "disability". This detailed analysis also addresses the goal of analysing the definitions of and criteria for the recognition of a "disability" for tax purposes as well as the goal of analysing the specific expenditure items that qualify for the additional rebate in consequence of a person's physical impairment or "disability". The final part of this chapter is a discussion of the provisions of the Income Tax Act as they pertain to special trusts. The inclusion of such discussion is aimed at achieving the goal of analysing the specific provisions of the Income Tax Act that are applicable to a special trust created for the benefit of a person with a physical impairment or "disability" as well as the goal of analysing the South African tax legislation that is specifically applicable to a person who has a physical impairment or a "disability".

2.2 Brief overview of the transition from section 18 to sections 6A and 6B

In terms of section 23(a) of the Income Tax Act,

> no deduction shall in any case be made in respect of
>
> > the cost incurred in the maintenance of any taxpayer, his family or establishment…

This implies that medical expenses would not be deductible in arriving at the taxable income of a person or his or her dependants. In terms of section 23(b) of the Income Tax Act,

> no deduction shall in any case be made in respect of
>
> > domestic or private expenses, including the rent of or cost of repairs of or expenses in connection with any premises not occupied for the purposes of trade or any dwelling-house or domestic premises except in respect of such part as may be occupied for the purposes of trade…

This, in turn, implies that no alterations to domestic premises to accommodate persons with physical disabilities would be deductible in arriving at a person's taxable income. The provisions of sections 23(a) and 23(b) therefore imply that medical expenditure paid by the taxpayer would not qualify for any form of tax relief as such expenditure could constitute "*the cost incurred in the maintenance of any taxpayer, his family or establishment"* or "*domestic or private expenses*". However, notwithstanding section 23, certain medical and disability-related expenditure incurred and paid by a natural person taxpayer may entitle such person to tax relief in the form of tax credits by virtue of sections 6A and 6B of the Income Tax Act. The section 6A tax credit is in respect of fees paid to a medical scheme and came into effect on 01 March 2012. The section 6B tax credit pertains to certain additional medical expenditure and came into effect from 1 March 2014.

Section 18 of the Income Tax Act previously provided for a deduction in respect of these medical expenses against the income of a natural person taxpayer, in determining his or her taxable income. Regular reference is made to the now repealed section 18 in this thesis and several comparisons are made between the provisions of sections 6A and 6B and that of the deleted section 18. Accordingly, it is of value to state the repealed section 18 in its final form:

> (1) Notwithstanding the provisions of section 23, there must be allowed to be deducted from the income of any taxpayer who is a natural person an allowance in respect of—
>
> > (a) any contributions made by that taxpayer in respect of the year of assessment in respect of that taxpayer, his or her spouse and any dependant, as defined in section 1 of the Medical Schemes Act, 1998 (Act 131 of 1998), of that taxpayer to—
> >
> > > (i) any medical scheme registered under the provisions of that Act; or

(ii) any fund which is registered under any similar provision contained in the laws of any other country where the medical scheme is registered;

(b) any amounts (other than amounts recoverable by the taxpayer or his or her spouse) which were paid by the taxpayer during the year of assessment to any duly registered—

(i) medical practitioner, dentist, optometrist, homeopath, naturopath, osteopath, herbalist, physiotherapist, chiropractor or orthopedist for professional services rendered or medicines supplied to the taxpayer, his or her spouse or his or her children, or any dependant of the taxpayer; or

(ii) nursing home or hospital or any duly registered or enrolled nurse, midwife or nursing assistant (or to any nursing agency in respect of the services of such a nurse, midwife or nursing assistant) in respect of the illness or confinement of the taxpayer, his or her spouse or his or her children, or any dependant of the taxpayer; or

(iii) pharmacist for medicines supplied on the prescription of any person mentioned in subparagraph (i) for the taxpayer, his or her spouse or his or her children, or any dependant of the taxpayer; and

(c) any amounts (other than amounts recoverable by the taxpayer or his or her spouse) which were paid by the taxpayer during the year of assessment in respect of expenditure incurred outside the Republic on services rendered or medicines supplied to the taxpayer or his or her spouse or children, or any dependant of the taxpayer, and which are substantially similar to the services and medicines in respect of which a deduction may be made under paragraph (b) of this subsection; and

(d) any expenditure that is prescribed by the Commissioner (other than expenditure recoverable by the taxpayer or his or her spouse) necessarily incurred and paid by the taxpayer in consequence of any physical impairment or disability suffered by the taxpayer, his or her spouse or child, or any dependant of the taxpayer.

(2) The allowance under subsection (1) is equal to—

(a) where the taxpayer is entitled to a rebate under section 6(2)(b), the sum of the amounts referred to in subsection (1);

(b) where the taxpayer, his or her spouse or his or her child is a person with a disability, the aggregate of —

(i) the sum of the amounts referred to in subsection (1)(b), (c) and (d); and

(ii) so much of the contributions made by the taxpayer as contemplated in subsection (1)(a) as exceeds four times the amount of the medical scheme fees tax credit in respect of that taxpayer in terms of section 6A; or

(c) in any other case—

(i) so much of the contributions made by the taxpayer during the relevant year of assessment as contemplated in subsection (1)(a), as exceeds four times the amount of the medical scheme fees tax credit in respect of that taxpayer in terms of section 6A; and

(ii) so much of the sum of all amounts contemplated in subsection (1)(b), (c) and (d),

as in the aggregate exceeds 7,5 per cent of the taxpayer's taxable income (excluding any retirement fund lump sum benefit and retirement fund lump sum withdrawal benefit) as determined before allowing any deduction under this subparagraph.

(3) For the purposes of this section "disability" means a moderate to severe limitation of a person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation—

(a) has lasted or has a prognosis of lasting more than a year; and

(b) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner.

(4) For the purposes of this section the expression "child" means the taxpayer's child or child of his or her spouse who was alive during any portion of the year of assessment, and who on the last day of the year of assessment—

(a) was unmarried and was not or would not, had he lived, have been—

(i) over the age of 18 years;

(ii) over the age of 21 years and was wholly or partially dependent for his maintenance upon the taxpayer and has not become liable for the payment of normal tax in respect of such year; or

(iii) over the age of 26 years and was wholly or partially dependent for his maintenance upon the taxpayer and has not become liable for the payment of normal tax in respect of such year and was a full-time student at an educational institution of a public character; or

(b) in the case of any other child, was incapacitated by a disability from maintaining himself or herself and was wholly or partially dependent for maintenance upon the taxpayer and has not become liable for the payment of normal tax in respect of such year.

(4A) For purposes of this section 'dependant' in relation to a taxpayer means—

(a) his or her spouse;

(b) his or her child and the child of his or her spouse;

(c) any other member of his or her immediate family in respect of whom he or she is liable for family care and support; and

(d) any other person who is recognised as a dependant of that person in terms of the rules of a medical scheme or fund contemplated in subsection (1)(a)(i) or (ii),

at the time the contributions contemplated in subsection (1)(a) were made, the amounts contemplated in subsection (1)(b) or (c) were paid or the expenditure contemplated in subsection (1)(d) was incurred and paid.

(5) For purposes of this section, any amount contemplated in subsection (1), which has been paid by—

(a) the estate of a deceased taxpayer is deemed to have been paid by the taxpayer on the day before his or her death; or

(b) an employer of the taxpayer must, to the extent that the amount has been included in the income of that taxpayer as a taxable benefit in terms of the Seventh Schedule, be deemed to have been paid by that taxpayer.

Notwithstanding section 23, section 18 allowed for the deduction of private expenses such as medical expenditure and certain other expenses incurred in consequence of a "disability". For the 2013 and 2014 years of assessment, section 6A provided for a medical schemes fees tax credit whilst section 18 made provision for a deduction in respect of excess medical scheme fees and other medical expenditure. The extent to which a person could deduct these additional expenses was determined by factors such as a taxpayer's age, their taxable income or whether they or their dependant had a physical impairment or "disability". For those two tax years, a person over the age of 65 did not qualify for the section 6A credit, but was entitled to deduct all of their medical scheme contributions and any other allowable non-recoverable medical expenses paid by them. From 1 March 2014, all taxpayers contributing to a medical scheme, regardless of their age, are entitled to the section 6A medical scheme fees tax credit and section 6B determines, based on the same factors as section 18 did, the extent to which a person will obtain a tax credit in respect of additional medical expenditure.

It is important to note that only a natural person qualifies for the section 6A and 6B tax credits and thus a trust or company would not be entitled to such relief. Thus it would appear that where a trust, for example, created to provide for the needs of a disabled person, pays the medical expenses of the beneficiary of the trust, the trust would not be granted a tax deduction or credit. Special trusts are discussed in section 2.5 below. What follows is an in-depth analysis of the provisions of sections 6A and 6B and how they culminate in tax credits for a taxpayer in certain circumstances and the extent of such relief. Section 6A provides tax relief to all individual taxpayers who have made medical scheme contributions. The relief that is provided by section 6A is a fixed credit based on the number of members per month in the tax period. The age of the taxpayer and whether or not the taxpayer or his or her dependant is a person with a physical impairment or "disability" are irrelevant factors when determining the value of the section 6A credit. Section 6B provides additional tax relief in respect of "excess" medical scheme contributions, out-of-pocket medical expenses, and non-medical expenses that are necessarily incurred and paid by the taxpayer in consequence of physical impairment or "disability". The concept of "excess" medical scheme contributions will be discussed when addressing the section 6B additional medical expenses tax credit in

detail below. The extent to which a taxpayer is entitled to the additional relief as contemplated in section 6B is determined based on the taxpayer's status as follows:

- the taxpayer was or, had he or she lived, would have been 65 years of age or older last day of the year of assessment in question;
- the taxpayer, his or her spouse or his or her child is a person with a "disability"; or
- all other individual taxpayers (including taxpayers who have a physical impairment that does not meet the qualifying criteria for a "disability" as defined or a taxpayer who has a spouse or child with such physical impairment).

2.3 Section 6A tax credit

A natural person taxpayer is entitled to the medical scheme fees credit (or rebate) in respect of the contributions made by the taxpayer to a medical scheme. The amount of such credit is determined with reference to section 6A(2)(b).

In terms of section 6A(1),

> a rebate, to be known as the medical scheme fees tax credit, must be deducted from the normal tax payable by a person who is a natural person…

The medical schemes fees tax credit is a rebate and not a deduction. Accordingly, the credit directly reduces the normal tax liability of a taxpayer instead of reducing the taxpayer's taxable income on which the normal tax liability is calculated. The medical schemes tax credit cannot reduce the normal tax payable by the taxpayer where such taxpayer has a normal tax liability of zero (either because the normal tax rebates provided for in section 6 of the Income Tax Act reduce the tax liability to nil, or because the person has an assessed loss) and such excess does not give rise to a refund by SARS or qualify to be rolled over to a future year of assessment. It should be noted that the repealed section 18 medical deduction could create an assessed loss for a taxpayer that could be carried forward to the following year of assessment. To this extent, the rebate provided for in section 6A is more restrictive than the section 18 deduction.

Each person with a disability is faced with a unique set of medical and non-medical related expenses that he or she incurs in consequence of his or her disability. The presence of a disabling condition can place a person at increased risk for one or more secondary conditions such as diabetes and cardiovascular disease (Kinne, Patrick and Doyle: 2004). Disabling and

secondary conditions generally require people with disabilities to make greater use of health care than the general population, resulting in higher health care expenditures, out-of-pocket spending, and financial burden compared with people without disabilities (Mitra, Findley and Sambamoorthi: 2004). A person with a disability might require constant occupational therapy, physiotherapy, speech therapy, psychotherapy, prescription medication and other ongoing medical care that a person without a disability would not require. Notwithstanding the potential increased use of health care, in terms of section 24(2)(e) of the Medical Schemes Act 131 of 1998, (referred to as "the Medical Schemes Act"),

> No medical scheme shall be registered under this section unless the Council is satisfied that the medical scheme does not or will not unfairly discriminate directly or indirectly against any person on one or more arbitrary grounds including, race, gender, marital status, ethnic or social origin, sexual orientation, pregnancy, disability and state of health.

Whilst a medical scheme may not discriminate against a person on the grounds of his or her disability or state of health, in terms of section 29A(2) of the Medical Schemes Act,

> A medical scheme may impose upon any person in respect of whom an application is made for membership or admission as a dependant, and who was previously a beneficiary of a medical scheme for a continuous period of up to 24 months, terminating less than 90 days immediately prior to the date of application –
>
> a) a condition-specific waiting period of up to 12 months, except in respect of any treatment or diagnostic procedures covered within the prescribed minimum benefits;
>
> b) in respect of any person contemplated in this subsection, where the previous medical scheme had imposed a general or condition specific waiting period, and such waiting period had not expired at the time of termination, a general or condition-specific waiting period for the unexpired duration of such waiting period imposed by the former medical scheme.

Section 29A(1) of the Medical Schemes Act allows a medical scheme to impose a general waiting period of up to three months and a condition-specific waiting period of up to 11 months in the case where an application is made for membership or admission as a dependant and that person has not been a beneficiary of a medical scheme for a period of at least 90 days preceding the date of the application.

Accordingly, although a medical scheme may not discriminate against a person on the grounds of his or her disability, a medical scheme can impose condition-specific waiting periods and it could be that the person's disability or an aspect of their disability is the subject of such waiting period. It should be noted that a treatment or diagnostic procedure covered within the prescribed minimum benefits cannot be included in the waiting period. For example, a person with Bipolar Mood Disorder applying for medical scheme coverage for the first time must be covered by the scheme for the prescribed minimum psychotherapy sessions in accordance with the gazetted treatment algorithm for that condition (Government Gazette: 2009). However, if that person requires more sessions and the medical scheme policy which he or she has selected would ordinarily cover those sessions, the scheme may impose a waiting period for the coverage of those additional sessions if the Bipolar Mood Disorder had been diagnosed prior to the person making the membership application.

It has been established that a medical scheme cannot discriminate on the grounds of disability, but the medical scheme can impose waiting periods. A medical scheme may not, for example, refuse coverage of person on the grounds of their disability, nor can they charge the person a higher premium on the sole basis of the presence of their disability. Notwithstanding this legislated protection, owing to the anticipated greater use of health care by a person with a disability, it is likely that a person with a disability would be required to opt for a policy of the medical scheme which provides more coverage. It is important for the person to determine his or her health care requirements and to evaluate whether the particular policy will provide coverage in respect of those needs. For example, a person might require an average of 35 physiotherapy sessions during a calendar year and the medical scheme has a scheme-wide rule of covering a maximum of five physiotherapy sessions during such period, irrespective of the policy the person selects. In such circumstances, it might not be beneficial for the person to incur the cost of higher premiums for a policy that offers more coverage as the additional coverage might not cover their unique needs. The table below compares three plans offered by Discovery medical scheme.

Table 1 Discovery Medical Scheme plans compared

Executive	**Classic Comprehensive**	**Classic Core**
Main member: R3 410 per month (2015)	Main member: R2 772 per month (2015)	Main member: R1 617 per month (2015)
Unlimited cover in any private hospital, including private ward	Unlimited private hospital cover	Unlimited private cover

cover		
Guaranteed full cover in hospital for specialists on a payment arrangement, and up to 300% of the Discovery Health Rate for other specialists	Guaranteed full cover in hospital for specialists on a payment arrangement, and up to 200% of the Discovery Health Rate for other healthcare professionals	Guaranteed full cover in hospital for specialists on a payment arrangement, and up to 200% of the Discovery Health Rate for other healthcare professionals
Full cover for chronic medicine for all CDL conditions plus some additional chronic conditions; plus access to an exclusive list of brand medicines	Full cover for chronic medicine for all CDL plus some additional chronic conditions	Full cover for chronic medicine for all CDL chronic conditions
Cover for medical emergencies when travelling	Cover for medical emergencies when travelling	Cover for medical emergencies when travelling
Covers first R400 000 of approved cancer treatment in full over a 12-month cycle.	Covers first R400 000 of approved cancer treatment in full over a 12-month cycle.	Covers first R200 000 of the approved cancer treatment in full over a 12-month cycle.
Covers day-to-day medical expenses like GP visits, radiology and pathology at the rate the healthcare professional charges.	Pays for day-to-day medical expenses like GP visits, radiology and pathology as long as you have money available.	This plan does not offer this benefit.
Provides unlimited cover for a list of allied healthcare services, like physiotherapy. This unlimited cover is for a defined list of conditions, for example quadriplegia and cerebral palsy. Cover depends on your condition and the criteria for it.	Provides unlimited cover for a list of allied healthcare services, like physiotherapy. This unlimited cover is for a defined list of conditions, for example quadriplegia and cerebral palsy. Cover depends on your condition and the criteria for it.	This plan does not offer this benefit.
The highest savings account and unlimited Above Threshold Benefit for your day-to-day healthcare needs	A high savings account and an unlimited Above Threshold Benefit for your day-to-day healthcare needs	This plan does not offer this benefit.
Additional cover for GP	Additional cover for GP	This plan does not offer this

consultation fees, preferred medicine, blood tests, maternity costs and some durable external medical items	consultation fees, preferred medicine, blood tests, maternity costs and some durable external medical items, depending on the plan you chose	benefit.
Access to specialised, advanced medical care in SA and abroad	Access to specialised, advanced medical care in SA and abroad	This plan does not offer this benefit.

Source: Discovery Health (2015: online)

It is anticipated that a person with a disability will be required to select a medical scheme policy which provides more coverage than a person without a disability would need. This is based on the assumption made above that a person with a disability is likely to have a greater need for health care products and services. Thus a member who is disabled or whose dependant is disabled and who cannot afford the higher fees may be faced with high out-of-pocket expenses not covered by the *Classic Core* option.

2.3.1 The tax credit

In terms of section 6A(2)(a),

> The medical scheme fees tax credit applies in respect of fees paid by the person to-
>
> (i) a medical scheme registered under the Medical Schemes Act; or
>
> (ii) a fund which is registered under any similar provision contained in the laws of any other country where the medical scheme is registered.

In order to qualify for the section 6A tax credit, the fees paid to a medical scheme need to be paid by the taxpayer him- or herself. Accordingly where the taxpayer's spouse, or anyone else (a trustee, for example), makes payment of the fees, such fees should not entitle the taxpayer to the applicable relief. Section 6A(3) provides two exceptions to this rule which will be discussed later.

The fees paid by the taxpayer may be paid to any registered medical scheme and not only to the medical scheme of which the taxpayer is a member. Accordingly, this allows taxpayers to take into account medical scheme fees that they have paid in respect of a dependant who is a member of a different medical scheme.

The amount of the medical scheme fees tax credit is determined by section 6A(2)(b) and is adjusted annually by the Rates and Monetary Amounts and Amendment of Revenue Laws Act. At the time of writing, the most recent Rates and Monetary Amounts and Amendment of Revenue Laws Act is that which is applicable to the 2015 year of assessment and the credit amount is adjusted such that section 6A(2)(b) will read as,

> The amount of the medical scheme fees tax credit must be-
>
> (i) R257, in respect of the benefits to the person;
>
> (ii) R514, in respect of the benefits to the person and one dependant; or
>
> (iii) R514, in respect of the benefits to the person and one dependant, plus R172 in respect of benefits to each additional dependant,
>
> for each month in that year of assessment in respect of which those fees are paid.

The amount of the credit is determined with reference to the number of people in respect of whom the medical scheme contributions are made and is calculated for each month in the year of assessment. The tax credit reflects a reduction in the tax liability and, if the assumption is made that the taxpayer is the only member, is taxed at the minimum marginal rate of 18% and can only afford the fee for the *Classic Core* option (see above), the value of the tax credit is: R257/0,18 = R1 428 (per month), compared with a fee of R1 617. For a taxpayer paying tax at the maximum marginal rate of 41% and paying a monthly fee of R3 410 for the *Executive* option, the value of the tax credit is R257/0,41 = R627. For taxpayers whose taxable income is below the tax threshold, the tax credit has no value. There is clearly a discrepancy between the amount of the tax credit and the monthly fee payable to the medical scheme. However, the excess medical scheme fee qualifies for a further limited credit in terms of section 6B (discussed below).

2.3.2 The term "dependant"

In terms of Section 6A(4) of the Income Tax Act, it is necessary to turn to the definition of "dependant" as contained in the Medical Schemes Act, to determine whether a person is a "dependant" for the purposes of section 6A.

The term "dependant" is defined in section 1 of the Medical Schemes Act as,

(a) the spouse or partner, dependent children or other members of the member's immediate family in respect of whom the member is liable for family care and support; or

(b) any other person who, under the rules of a medical scheme, is recognised as a dependant of such a member and is eligible for benefits under the rules of the medical scheme.

A strict interpretation of the law would conclude that a taxpayer will only be entitled to the section 6A medical schemes fees credit in respect of contributions which are made to a medical scheme in respect of a taxpayer's "dependant" if the taxpayer him or herself is a member of a medical scheme. The Medical Schemes Act defines "medical scheme" as *"any medical scheme registered under section 24 (1)"*.

Accordingly, the medical scheme in question needs to be one which is registered in terms of the Medical Schemes Act.

The term "member" is defined in the Medical Schemes Act as *"a person who has been enrolled or admitted as a member of a medical scheme, or who, in terms of the rules of a medical scheme, is a member of such medical scheme"*.

This definition of "member" allows for two categories of people to be considered a member of a medical scheme; those who are enrolled or admitted as a member of a medical scheme in the ordinary sense and those who are a member of a medical scheme in terms of the rules of such a scheme. In terms of the rules, for example, of the Discovery Health Scheme, a member is defined as *"a person who is admitted as a member in terms of these Rules but does* <u>not</u> (own emphasis) *include a dependant"* (Discovery Health, 2012a:9).

Thus, in the ordinary sense, someone who is merely a dependant of a principal member of a medical scheme must themselves be a member of a medical scheme. Accordingly, if someone who is a dependant of a principal member (and a member) of a medical scheme, for example a spouse, were to make contributions to *another* medical scheme in respect of his or her "dependant", such contributions should be considered to be fees paid to a medical scheme in respect of benefits provided to a "dependant" of the taxpayer, even if the taxpayer is not a member of a medical scheme in accordance with the rules of the other scheme.

Subparagraph (i) of section 6A(2)(b), however, determines the amount of the monthly credit in respect of benefits to the taxpayer, subparagraph (ii) determines such credit in respect of

benefits to the taxpayer *and* one dependant, and subparagraph (iii) sets the credit in respect of benefits to the taxpayer *and* more than one dependant. Notwithstanding the argument that indicates that a person who is a dependent (not a principal member) on one medical scheme who pays fees to another medical scheme for the benefit of his or her dependant should be considered to have paid fees to a medical scheme for the benefit of a "dependant" as defined, it would appear that section 6A(2)(b) does not provide for this situation. Each subparagraph of section 6A(2)(b) first requires that the medical scheme fees be paid in respect of benefits to the taxpayer, and then subparagraphs (ii) and (iii) provide for the credit in instances where, in addition to benefits to the taxpayer, there are also benefits for one or more dependants of the taxpayer. An example of where this technicality could be to the detriment of the taxpayer is when a taxpayer pays the medical scheme contributions for her child from a previous marriage whilst she is a dependant on a different medical scheme of which her new husband is the principal member. In this scenario, the taxpayer has not paid any medical scheme contributions in respect of benefits to herself, which means technically, none of the section 6A(2)(b) subparagraphs could apply, as they refer to "*benefits to the person and . . .*". It is submitted that this is not the intention of the legislature and a recommended amendment to the legislation in this regard will be discussed in Chapter Four.

In order for a person to meet the requirements of paragraph (a) of the above definition of "dependant" in section 6A of the Income Tax Act, it is necessary for that person to be an immediate family member of the member of the medical scheme. The term "immediate family" is not defined in either the Medical Schemes Act or the Income Tax Act. In the *Guide on the Determination of Medical Tax Credits and Allowances* (hereinafter referred to as "the SARS guide") SARS (2014b:2) notes that the term encompasses a particular group of relatives and, with reference to the Blacks Law Dictionary definition of "immediate family", states that, *"this group is limited to a person's spouse or life partner, parents (including adopted and step-parents), children (including adopted and step-children) and siblings."*

Neither the Medical Schemes Act or section 6A include a definition of the term "spouse" and it is thus necessary to turn to its definition as contained in section 1 of the Income Tax Act, which reads as follows:

> in relation to any person, means a person who is the partner of such person –
>
> (a) in a marriage or customary union recognised in terms of the laws of the Republic;

(b) in a union recognised as a marriage in accordance with the tenets of any religion; or

(c) in a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent,

and 'married', 'husband' or 'wife' shall be construed accordingly.

Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property;

The laws of South Africa to which paragraph (a) of the definition of "spouse" refers are:

- the Marriage Act, No. 25 of 1961;
- the Recognition of Customary Marriages Act, No. 120 of 1998; and
- the Civil Union Act, No. 17 of 2006.

Given that African customary law allows for polygamous marriages, and such marriages are recognized as legal by the Recognition of Customary Marriages Act, it is thus possible that a particular taxpayer could be entitled to a medical schemes fees tax credit for medical aid contributions made in respect of more than one spouse.

Paragraph (b) of the definition of "spouse" as contained in section 1 of the Income Tax Act does not include a requirement that the Commissioner needs to be satisfied that the union is intended to be permanent and thus it would appear that so long as the union is recognised as a marriage in accordance with the key beliefs of any religion, a person who is a partner of the taxpayer in such union should be considered a spouse of the taxpayer. It is submitted that in most instances, a union as contemplated in paragraph (b) is likely to have been taken into consideration in terms of paragraph (a).

The Civil Union Act which came into effect on 30 November 2006 will have partially relieved the Commissioner of the task of having to be satisfied of a couple's intention of permanent union in the case of same-sex unions (PWC: 2012). In circumstances where the union, as contemplated in paragraph (c) of the definition of "spouse", is not one which has been recognised in terms of the Civil Union Act, the taxpayer would be required to provide sufficient evidence to the Commissioner that the union is intended to be of a permanent nature. The sharing of expenses, the existence of a joint household and the length of the

relationship are examples are factors that could be considered by the Commissioner in determining the intention of the couple (PWC: 2012).

A further requirement of paragraph (a) of the definition of "dependant" is that the medical scheme member must be liable for the family care and support of the person. Nel and Oberholzer (2006:9) suggest that this liability is not a contractual obligation and recommend that a broad interpretation is applied.

If a person has not met the requirements of paragraph (a) of the definition of "dependant", it is still possible that they could be regarded as a dependant by virtue of paragraph (b) of the definition if that person is recognised as a dependant of a member of a medical scheme in terms of the rules of such a scheme. In terms of the rules, for example, of the Discovery Health Scheme (Discovery Health, 2012a:6), a "dependant" is defined as,

- a member's spouse or partner who is not a member or registered dependant of a member of another medical scheme;
- a member's child who is not a member or a registered dependant of a member of another medical scheme;
- an adult dependant as defined;
- the immediate family of a member in respect of whom the member is liable in law for family care and support; or
- such other persons who are recognised by the Board as dependants for the purposes of these Rules.

The definition of "adult dependant" in the Discovery Health Scheme rules broadens the scope of who can be classified as a "dependant" and includes people such as a divorced spouse of a member and any relative of the member (Discovery Health, 2012a:3).

As each medical scheme has its own set of rules, in contrast with paragraph (a) of the definition of "dependant" as contained in section 1 of the Medical Schemes Act, it is not necessarily a requirement for paragraph (b) of the definition that the person is immediate family of the member.

2.3.3 The payment of fees

Once it has been determined that the contributions to a medical scheme were made by the taxpayer during the year of assessment and in respect of him- or herself, his or her spouse or dependant (as contemplated in the discussion above), those contributions should qualify for the applicable monthly medical scheme fees tax credit provided they are made to a medical scheme which has been registered under the provisions of the Medical Schemes Act or to any foreign based medical scheme which has been registered under similar provisions as contained in the laws of the country where that medical scheme is registered. In practice a medical scheme issues the taxpayer with a tax certificate which reflects the contributions received by the scheme in respect of the months March through to February in relation to any particular year of assessment.

There are two instances in which a taxpayer may be entitled to take the medical scheme fees credit into account without making payment of such fees him or herself. In terms of section 6A(3), for the purposes of section 6A, any amount contemplated in section 6A(2)

> that has been paid by-
>
> (a) the estate of a deceased person is deemed to have been paid by the person on the day before his or her death; or
>
> (b) an employer of the person is, to the extent that the amount has been included in the income of that person as a taxable benefit in terms of the Seventh Schedule, deemed to have been paid by that person.

Accordingly, the provisions of section 6A(3)(a) deem medical scheme fees that have been paid by the estate of a deceased person to have been made by the taxpayer him or herself on the day before his or her death. In terms of paragraph (b) of section 6A(3), any medical scheme fees paid by a taxpayer's employer will be deemed to have been paid by the taxpayer, to the extent that such amount has been included in the income of the taxpayer as a taxable fringe benefit.

These deeming provisions merely deem the amounts to have been paid by the taxpayer and it would still be necessary to determine whether the definition of "dependant" has been met,

where applicable. The deeming provisions do not apply to payments made by a trustee in respect of a disabled beneficiary of a trust. Special trusts are discussed in section 2.5 below.

The section 6A credit does not distinguish between a person with a "disability" and a person without a "disability". Although a person with a disability might be required to pay higher medical scheme premiums to ensure coverage of his or her greater health care, the same tax credit is provided irrespective of whether the person has a "disability" as defined. Medical scheme premiums which are in excess of three times the section 6A medical scheme tax credit to which the person is entitled to should qualify for relief under section 6B if the person has a "disability". Section 6B is discussed in section 2.4 below. The repealed section 18 (prior to section 6A coming into effect) allowed a person with a "disability" a deduction in respect of all of his or her premiums paid to a medical scheme. However, even with excess medical scheme contributions being taken into account through section 6B, the combination of the section 6A medical scheme fees tax credit and the section 6B additional medical expenses tax credit does create the situation that a person with a "disability" may not receive relief in respect of every Rand spent on medical scheme premiums.

2.4 Section 6B tax credit

Section 6B has four paragraphs, each with its own purpose, as follows:

- paragraph (1)
    - defines "child", "dependant", "disability", and "qualifying medical expenses" for the purposes of section 6B;
- paragraph (2)
    - provides for a rebate in respect of additional medical expenses;
- paragraph (3)
    - determines the amount of the additional medical expenses credit to be deducted from the normal tax payable by a natural person taxpayer; and
- paragraph (4)
    - sets out two deeming provisions in respect of amounts which were paid by the taxpayer's employer or deceased estate.

2.4.1 Section 6B(1) – definition of "child"

The term "child" is defined in section 1 of the Income Tax Act as

> in relation to any person, includes any person adopted by him or her-
>
> a) under the law of the Republic; or
>
> b) under the law of any country other than the Republic, provided the adopted person is under such law accorded the status of a legitimate child of the adoptive person and the adoption was made at a time when the adoptive parent was ordinarily resident in such country.

According to the SARS guide, the definition of a child does not include a child who has not yet been legally adopted or child who is under the taxpayer's custodianship (SARS, 2014: 3). A foster child is also not included in the definition of "child", regardless of how long the child is in the taxpayer's care.

In terms of section 6B(1), for the purposes of section 6B, "child" means -

> a person's child or child of his or her spouse who was alive during any portion of the year of assessment, and who on the last day of the year of assessment--
>
> a) was unmarried and was not or would not, had he or she lived, have been--
>
> i) over the age of 18 years;
>
> ii) over the age of 21 years and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of such year; or
>
> iii) over the age of 26 years and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of such year and was a full-time student at an educational institution of a public character; or
>
> b) in the case of any other child, was incapacitated by a disability from maintaining himself or herself and was wholly or partially dependent for maintenance upon the person and has not become liable for the payment of normal tax in respect of that year.

For the purposes of section 6B, a child includes the taxpayer's own or adopted child or a child or adopted child of the taxpayer's spouse. The term "spouse" is not defined for the purposes of section 6B and thus is given the meaning of "spouse" as defined in section 1 of the Income Tax Act. Accordingly, the child of any person meeting the definition of "spouse" as discussed with reference to section 6A above may be considered a child for the purposes of section 6B, provided the other requirements of the section 6B definition of "child" are met.

Any child of the taxpayer or the child of his or her spouse as discussed above, who is unmarried and is under the age of 18 on the last day of the applicable year of assessment, will meet the definition of "child" for the purposes of section 6B.

A child of the taxpayer or a child of his or her spouse who is unmarried and between the ages of 18 and 21 on the last day of the applicable year of assessment, will meet the definition of "child" for the purposes of section 6B if such child is wholly or partially dependent for maintenance upon the taxpayer. Furthermore, the child must not have become liable for the payment of normal tax in respect of that tax year.

When considering whether a child between the ages of 18 and 21 meets the definition of a "child" for the purposes of section 6B, it is necessary to determine if such child has become liable for normal tax in respect of the applicable year of assessment. All allowable amounts should be deducted from all income received by or accrued to the child to arrive at the child's taxable income. After calculating the normal tax payable by the child in accordance with section 5(2) of the Income Tax Act, the primary rebate, as per section 6(2) of the Income Tax Act, must be taken into account in order to determine whether the child is liable for normal tax. For any given year of assessment, if the child's deductions exceed his or her income, the child would incur an assessed loss. An assessed loss will not give rise to a normal tax liability; accordingly, if a person's child is between the ages of 18 and 21 and the child incurs an assessed loss and that child is wholly or partially dependant on the person for his or her maintenance, the child would meet the definition of a "child" in relation to that person. It should be noted that a child would also meet the requirement of having not become liable for income tax if he or she had no income in the particular year of assessment.

An unmarried child between the ages of 18 and 21 who is not liable for normal tax as determined above and who is wholly or partially reliant on the taxpayer for his or her maintenance will be considered a "child" for the purposes of section 6B.

Where the taxpayer's child or the child of his or her spouse is unmarried and is older than 21 but younger than 26 on the last day of the applicable year of assessment, such child will meet the definition of "child" for the purposes of section 6B if that child is wholly or partially dependent on the taxpayer for maintenance. The child must also not have become liable for the payment of normal tax in respect of that year of assessment. Furthermore, the child must be a full-time student at a public educational institution.

There is no requirement that the public educational institution must be at a tertiary level and thus a qualifying child between the ages of 21 and 26 who is a full-time student at a primary or secondary level of education should still be considered a "child" for the purposes of section 6B.

Regardless of the child's marital status or age, if a taxpayer's child or the child of his or her spouse is on the last day of the applicable year of assessment, incapacitated by a "disability" from maintaining him or herself and that child is wholly or partially dependent for maintenance upon the taxpayer, that child will be considered a "child" for the purposes of section 6B, provided that child has not become liable for the payment of normal tax in respect of that tax year.

There are two steps to determining whether the child is incapacitated by a "disability" from maintaining him or herself. Firstly, the child needs to have a "disability" as defined in section 6B(1); this definition will be discussed in detail below. Secondly, the "disability" must incapacitate the child from maintaining him or herself. The fact that the child has a "disability" as defined is not sufficient on its own to meet the definition of a "child" for the purposes of section 6B.

A child with a "disability" as defined, but who is not incapacitated by that "disability" from maintaining him or herself, and who is unmarried and between the ages of 18 and 21, will only be considered a "child" for the purposes of section 6B if that child is wholly or partially dependent for maintenance upon the taxpayer and the child has not become liable for normal tax.

A child with a "disability" as defined, but who is not incapacitated by that "disability" from maintaining him or herself, and who is unmarried and between the ages of 21 and 26, will only be considered a "child" for the purposes of section 6B if that child is wholly or partially

dependent for maintenance upon the taxpayer and the child has not become liable for normal tax. Furthermore the child must be a full-time student at a public educational institution.

A child with a "disability" as defined, but who is not incapacitated by that "disability" from maintaining him or herself, and who is unmarried and over the age of 26, will not be considered a "child" for the purposes of section 6B.

2.4.2 Section 6B(1) – definition of "dependant"

In terms of section 6B(1), for the purposes of section 6B, "dependant" means –

(a) a person's spouse;

(b) a person's child and the child of his or her spouse;

(c) any other member of a person's family in respect of whom he or she is liable for family care and support; and

(d) any other person who is recognised as a dependant of that person in terms of the rules of a medical scheme or fund contemplated in section 6A(2)(a)(i) or (ii)

at the time the contributions contemplated in section 6A(2)(a) were paid, the amounts contemplated in paragraph (a) and (b) of the definition of "qualifying medical expenses" were paid or the expenditure contemplated in paragraph (c) of that definition was incurred and paid.

The previous discussions with regard to the definitions of the terms "spouse" and "child" are applicable when considering paragraphs (a) and (b) of the definition of "dependant" for the purposes of section 6B.

The section 6B definition of the term "dependant" is very similar to that contained in section 1 of the Medical Schemes Act and, thus, also the definition of "dependant" for the purposes of section 6A of the Income Tax Act. The Medical Schemes Act definition of "dependant" includes members of the member's immediate family in respect of whom the member is liable for family care and support, whilst the section 6B definition appears to be broader in that it includes *any* of the taxpayer's family members in respect of whom the taxpayer is liable for such family care and support and not only the taxpayer's immediate family members. In most cases, this difference should be irrelevant because the Medical Schemes

Act definition of dependant also includes any other person who, under the rules of a medical scheme, is recognised as a dependant of the member.

2.4.3 Section 6B(1) – definition of "disability"

In terms of section 6B(1), for the purposes of section 6B, "disability" means –

> a moderate to severe limitation of any person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation—
>
> a) has lasted or has a prognosis of lasting more than a year; and
>
> b) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner.

Accordingly, a person will only be regarded as having a "disability" as defined if the limitation as contemplated in the definition meets two distinct requirements. The first relates to duration; it is necessary for the limitation to have lasted for more than a year or to have a prognosis of lasting more than a year. The term "year" is not defined in the Income Tax Act. Accordingly, its ordinary meaning of "*a unit of time that is equal to 12 months*" as contained in the Merriam-Webster Dictionary (2013: online) should be applicable. It should be noted that the requirement that the limitation must have lasted a year or must have a prognosis of lasting more than a year makes no reference to a "year of assessment". The second requirement is that the limitation needs to have been diagnosed by a duly registered medical practitioner. A further element of this second requirement is that the diagnosis needs to be in accordance with criteria that have been prescribed by the Commissioner.

The criteria for diagnosis were first published and announced by SARS in a media release on 20 April 2010 (SARS, 2010a:1). This is the same media release in which SARS first introduced the prescribed list of qualifying expenditure; this will be discussed below. The prescribed criteria for diagnosis are set out on a form titled "*Confirmation of Diagnosis of Disability*", hereinafter referred to by its SARS form reference "ITR-DD". As will be discussed below in relation to paragraph (a) of the definition of "qualifying medical expenses", the term "medical practitioner" could be strictly interpreted to mean a medical doctor and would exclude professionals such as an occupational therapist, a psychologist, a speech therapist or a physiotherapist. It is important to note, however, that the SARS

interpretation of the term differs from this narrow viewpoint. It is stated on the ITR-DD form that a medical practitioner is "*a person required to register with the Health Professional Council of South Africa*" (SARS, 2010b:1). Accordingly, as the terms "duly registered" and "medical practitioner" are not defined in the Income Tax Act, based on the ITR-DD, "duly registered medical practitioner" can be interpreted to mean any person who is required to register with the Health Professional Council of South Africa. It should be noted that the ITR-DD *does* state that the medical practitioner must be specially trained to deal with the applicable disability. Owing to the fact that paragraph (b) of the definition of "disability", as contained in section 6B(1), requires the diagnosis to be in accordance with criteria prescribed by the Commissioner, the contents of the ITR-DD carry significant evidential weighting. The legislature has granted the Commissioner the authority to dictate the diagnosis criteria and the ITR-DD is the document used by SARS to do this. It is submitted that such authority should not lie within the Commissioner's power and, as will be the case with regard to the power granted to the Commissioner to prescribe a list of qualifying medical expenditure incurred in consequence of a physical impairment or "disability", a recommended amendment in this respect will be discussed in Chapter Four.

The term "moderate to severe limitation" is not defined in the Income Tax Act. As shown on the ITR-DD form, SARS has interpreted the term, in the context of disability, to mean "*a significant restriction on a person's ability to function or perform one or more basic daily activities after maximum correction, except where indicated*." Furthermore, "maximum correction", in this context, means "*appropriate therapy, medication and use of devices*."

2.4.4 Section 6B(1) – definition of "qualifying medical expenses"

Paragraph (a)

The first type of medical expenditure contemplated in the definition of "qualifying medical expenses" as contained in section 6B(1) relates to non-recoverable amounts paid for medical services and medication. Paragraph (a) of the definition provides for:

> any amounts (other than amounts recoverable by a person or his or her spouse) which were paid by the person during the year of assessment to any duly registered –
>
> (i) medical practitioner, dentist, optometrist, homeopath, naturopath, osteopath, herbalist, physiotherapist, chiropractor or orthopaedist for

professional services rendered or medicines supplied to the person or any dependant of the person;

(ii) nursing home or hospital or any duly registered or enrolled nurse, midwife or nursing assistant (or to any nursing agency in respect of the services of such a nurse, midwife or nursing assistant) in respect of the illness or confinement of the person or any dependant of the person; or

(iii) pharmacist for medicines supplied on the prescription of any person mentioned in subparagraph (i) for the person or any dependant of the person.

Any particular medical expenditure item will not be considered "qualifying medical expenses" to the extent that the amount is recoverable by the taxpayer or his or her spouse. The legislation does not limit the scope of the recovery and thus a strict interpretation would mean that if the taxpayer paid an amount to any duly registered person or establishment as contemplated in paragraph (a) of the definition of "qualifying medical expenses" and the taxpayer or his or her spouse is to be reimbursed for that particular expenditure by a medical scheme, a sponsor, a public benefit organisation, or any other source, such expenditure should not qualify to the extent that it is recoverable. This principle is sound as the taxpayer is in essence not incurring the expenditure. According to SARS (2014b:10), "*in order for the expenses to be considered for deduction, the expense must not have been recoverable from the taxpayer's medical scheme*" (own emphasis). It would appear that SARS has interpreted the legislation to mean that the scope of recovery is limited to those amounts which are recoverable from the taxpayer's medical scheme.

A strict interpretation of the definition of 'qualifying medical expenses' would result in expenditure only qualifying for the envisaged relief if the taxpayer does not have the ability to recover such expenditure. The legislation makes use of the word "recoverable" instead of the word "recovered". If this is interpreted strictly, if a taxpayer is in a position to recover an expense from another party, but pays such expense him- or herself and does not act on that ability to recover the expense, such expense should not qualify. For example, if a taxpayer's medical scheme provides coverage for a particular expense item that the taxpayer has paid for and the taxpayer does not claim that expense from the medical scheme, it could be argued that, based on the use of the word "recoverable" in the legislation, the taxpayer should not be entitled to tax relief in respect of that expense as the expense was recoverable. If one takes an even stricter approach in interpreting the definition of "qualifying medical expenses", it could

be said that if a taxpayer pays an expense and their spouse or any other third party was willing to reimburse the taxpayer in respect of that expense, but the taxpayer refuses the offer, such expense should not qualify as the taxpayer had the ability to recover it. It is suggested that the definition of "qualifying medical expenses" as contained in section 6B(1) is amended by replacing the word "recoverable" with "recovered". A concern that could arise with the implementation of such amendment is that if an expense is paid during a particular tax year and, due to administrative processing, such expense will only be recovered by the taxpayer in the following tax year, the taxpayer could then argue that the expense had not been recovered during the relevant tax year. Accordingly, to avoid such situations, the amendment could be "recovered or to be recovered"

In order to qualify for the credit, the medical expenditure as contemplated in paragraph (a) of the definition of "qualifying medical expenses" must have been paid by the taxpayer him- or herself and thus amounts paid by the taxpayer's spouse or anyone else will not be taken into consideration when determining the taxpayer's qualifying expenditure. Furthermore, the amount must have been paid during the year of assessment and thus the mere incurring of a liability to pay during the period in question is not sufficient.

A requirement of paragraph (a) of the definition of "qualifying medical expenses" is that the person or establishment which the taxpayer has paid must be duly registered. The Income Tax Act does not provide for what is meant by "duly registered". Accordingly, it is submitted that the person or establishment should be registered with a regulatory body which has been formed in terms of specific legislation. There are several professional regulatory bodies which have been formed in South Africa which regulate health care professions in the country. The following table provides the regulatory body for each of the professions specifically mentioned in paragraph (a) of the definition of "qualifying medical expenses"

Table 2 Regulatory bodies: Professions listed in the definition of "qualifying medical expenses"

Regulatory Body	**Profession**
Health Professions Council of South Africa established in terms of the Health Professions Act No.56 of 1974	• medical practitioners • dentists • optometrists • physiotherapists • orthopedists

Allied Health Professions Council of South Africa established in terms of the Allied Health Professions Act No.63 of 1982	• naturopaths • osteopaths • homeopaths • chiropractors • herbalists
South African Pharmacy Council established in terms of the Pharmacy Act No.53 of 1974	• pharmacists
South African Nursing Council established in terms of the Nursing Act No.45 of 1944	• nurses • nursing assistants • mid-wives

It should be noted that the Income Tax Act does not define any of the professions stated in paragraph (a) of the definition of "qualifying medical expenses". Accordingly, it is submitted that the stated professions should be given the meaning assigned to them by the rules of the relevant regulatory body. Alternatively, the ordinary meaning of each profession should be applicable when interpreting paragraph (a) of the definition of "qualifying medical expenses".

The Health Professions Council of South Africa has established twelve separate boards and each board regulates at least one professional title. For example, The Medical & Dental Board includes, *inter alia*, the regulation of medical practitioners, anaesthetist's assistants, and dentists, whilst The Psychology Board regulates, *inter alia*, psychologists and registered counsellors. There is a separate board for Physiotherapy, Podiatry and Biokinetics, as well as one for Occupational Therapy, Medical Orthotics/Prosthetics and Arts Therapy. There is also a board for Speech, Language and Hearing Professions.

Both paragraph (a) of the definition of "qualifying medical expenses" and the Health Professions Council of South Africa distinguish between a medical practitioner and, for example, a physiotherapist, dentist, or optometrist. In addition, the Health Professions Council of South Africa distinguishes between a medical practitioner and a psychologist, speech therapist, or occupational therapist. This implies that the legislature and the relevant regulatory body do not classify these professionals as medical practitioners.

The Collins Dictionary (2013: online) defines "medical practitioner" as "*a qualified person who works as a doctor in a hospital or private practice*". The Oxford Dictionary (2013: online) defines the term as "*a physician or surgeon*".

Based on the fact that the legislature and the relevant regulatory body distinguish between a medical practitioner and other professions and that professions such as occupational therapist, psychologist, speech therapist and physiotherapist do not fall within the ordinary meaning of "medical practitioner", it is submitted that a strict interpretation of the legislation would mean that amounts paid by the taxpayer to persons other than those specifically mentioned in paragraph (a) of the definition of "qualifying medical expenses" should not be considered qualifying expenditure. For example, amounts paid to a physiotherapist would qualify as such person is specifically mentioned in paragraph (a) of the definition of "qualifying medical expenses", whereas amounts paid to a psychologist, speech therapist or occupational therapist would not. This is not necessarily the intention of the legislature and a recommended amendment to the legislation in this regard will be discussed in Chapter Four. It should be noted that SARS (2014b: 24) appear to regard, *inter alia*, clinical psychologists, speech-language pathologists and occupational therapists as medical practitioners as the SARS guide states "*duly registered <u>medical practitioners</u>* (own emphasis) *specifically trained to deal with a particular disability include the following . . .*:" and such professions are listed thereunder. Therefore, using the SARS interpretation of the term "medical practitioner", amounts paid to a psychologist, speech therapist or occupational therapist would be considered qualifying expenditure.

Only medicines bought from a duly registered pharmacist on the prescription a person mentioned in paragraph (a)(i) of the definition of "qualifying medical expenses", or medication acquired directly from such person will qualify.

If an amount paid by the taxpayer to a duly registered person or establishment as contemplated in paragraph (a) of the definition of "qualifying medical expenses" is to qualify, there is a further requirement that such amount must have been paid for in respect of the taxpayer or his or her dependant. The previous discussion with regard to the section 6B definition of "dependant" is applicable to the entire section 6B.

Paragraph (b)

The second type of medical expenditure contemplated in the definition of "qualifying medical expenses" relates to non-recoverable amounts paid for medical services and medication acquired from a source outside South Africa. Paragraph (b) of the definition provides for:

> any amounts (other than amounts recoverable by a person or his or her spouse) which were paid by the person during the year of assessment in respect of expenditure incurred outside the Republic on services rendered or medicines supplied to the person or any dependant of the person, and which are substantially similar to the services and medicines contemplated in paragraph (a).

The same principles discussed above with regard to recovery apply in the context of section paragraph (b) of the definition of "qualifying medical expenses" and thus any amount paid for which the taxpayer or his or her spouse is to be reimbursed should not qualify for deduction regardless of the source of such recovery. It should also be noted that the requirements of paragraph (a) with regard to the amount needing to be paid by the taxpayer him- or herself and that the mere creation of a liability is insufficient, apply equally to paragraph (b). In order for an amount to meet paragraph (b) of the definition of "qualifying medical expenses" it is necessary for the relevant services and medicines which were acquired from a foreign source to be "*substantially similar*" to those contemplated in paragraph (a). Furthermore, the amount paid by the taxpayer must have been in respect of the taxpayer his or her dependant.

The key differences between paragraphs (a) and (b) are that paragraph (a) requires the amount to have been paid to a duly registered person or establishment and paragraph (b) specifically mentions amounts paid outside South Africa. As mentioned in the discussion of paragraph (a), the Income Tax Act does not define what is meant by "duly registered" and thus it is submitted that the person or establishment should be registered with a regulatory body which has been formed in terms of specific legislation. Any person or establishment based outside South Africa which is able to offer services or medicines which are "*substantially similar*" to those contemplated in paragraph (a) is likely to have been "duly registered" in terms of the statutory requirements of the country in question. The legislation is not clear on this particular point and it is possible that "*substantially similar*" is intended to mean that the person or establishment from which the service or medicine is acquired must also be "duly registered". If this is the intended meaning, then there should be no need for the

inclusion of paragraph (b) in the definition of "qualifying medical expenses". It is unlikely that the legislature did not intend this meaning as this would result in a qualifying expense in respect of medical services and medicines acquired from any foreign based person or establishment regardless of whether or not they are registered with a regulatory body. It is therefore submitted that any amount which meets the definition of paragraph (b) would meet the definition of paragraph (a) because the latter does not specifically exclude expenditure incurred outside South Africa.

Paragraph (c)

The final type of medical expenditure contemplated in the definition of "qualifying medical expenses" as contained in section 6B(1) relates to that which is incurred in consequence of a physical impairment or "disability". Accordingly, in the context of this research, paragraph (c) is an important paragraph contained in section 6B (1). Paragraph (c) of the definition provides for:

> any expenditure that is prescribed by the Commissioner (other than expenditure recoverable by a person or his or her spouse) necessarily incurred and paid by the person during the year of assessment in consequence of any physical impairment or disability suffered by the person or any dependant of the person.

The aspects of recoverability of expenditure and the expenditure having to be paid by the taxpayer him- or herself, have already been elaborated on above. It should be noted that the words "*during the year of assessment*" are included in paragraph (c) of section 6B(1), but such reference to the timing of the payment was not included in the paragraph's predecessor, section 18(1)(d). Section 18(1)(a) required the payment of medical scheme contributions to be made in respect of the year of assessment and paragraphs (b) and (c) of section 18 required the payment to be made during the year of assessment, however, section 18(1)(d) had no such requirement. Section 18(1)(d), read as follows:

> any expenditure that is prescribed by the Commissioner (other than expenditure recoverable by the taxpayer or his or her spouse) necessarily incurred and paid by the taxpayer in consequence of any physical impairment or disability suffered by the taxpayer, his or her spouse or child, or any dependant of the taxpayer.

It is submitted that the legislature intended a deduction only in respect of those amounts which were paid during the year of assessment in consequence of any physical impairment or

"disability". The legislation was previously unclear and thus it is a welcome amendment. Owing to the relevance of paragraph (c) of section 6B(1) in the context of this research, the various components of the paragraph will be discussed in detail below.

"*prescribed by the Commissioner*"

Section 33(1)(a) of the Revenue Laws Amendment Act, No. 60 of 2008, added the words *"that is prescribed by the Commissioner"* to section 18(1)(d) with effect from the commencement of the 2010 year of assessment. Accordingly, only disability-related expenditure that has been prescribed by the Commissioner may be considered as a qualifying expense. To facilitate such prescription, SARS has issued a document entitled: *List of qualifying physical impairment or disability expenditure in terms of section 18(1)(d) of the Income Tax Act, No. 58 of 1962 (the Act)*, hereinafter referred to as "the prescribed list". At the time of this research, SARS had not yet published an updated list that makes reference to section 6B. The first publication of the prescribed list was announced in a media release by SARS on 20 April 2010 (SARS, 2010a:1) and was effective from 1 March 2009. Accordingly, the SARS list was effective from the commencement of the 2010 year of assessment, the first tax period for which the words "*that is prescribed by the Commissioner*" were applicable in respect of disability-related expenses. It should be noted that the SARS list was only released almost two months into the applicable tax year. It could be argued that a taxpayer should have been allowed to take an expense into account for the 2010 year of assessment if the expense was necessarily incurred and paid, prior to 20 April 2010, by the taxpayer, in consequence of a physical impairment or "disability", even if such expense is not one that is on the SARS list. An updated list has since been issued and is effective from the start of the 2013 year of assessment.

The SARS (2014b:30-35) prescribed list includes nine broad categories of expenditure:

- personal attendant care expenses;
- travel and other related expenses;
- insurance, maintenance, repairs and supplies;
- prosthetics;
- aids and other devices (excluding motor vehicles, security systems, swimming pools and other similar assets);
- services;

- continence products;
- service animals; and
- alterations or modifications to assets acquired or to be acquired.

For each broad category the prescribed list provides examples of the type of expenditure within that category that will qualify and for most of the categories there is a brief description of the qualifying requirements. Furthermore, the prescribed list also provides rules and exclusions for certain expenditure items; for example, a spouse, parent or child of a person with a "disability" is excluded as a care attendant and special education school fees are limited to the amount in excess of the fees of the closest fee-paying public school that does not specialise in special needs education.

The definition of "qualifying medical expenses" in no way prohibits an expense from being taken into account merely by virtue of the fact that such expense is capital in nature. For example, a taxpayer with a physical disability might require an elevator or ramp to be installed at his or her house in order to facilitate access. Such expenditure would be considered capital in nature, but will be allowed provided all of the other requirements of section 6B are met.

It should be noted that the prescribed list is not legislation in itself and is written in a manner and style which is intended to be easily understood by the general public. For example, the prescribed list makes use of language such as *"please remember"* and *"please note"*, as well as abbreviations which include *"e.g."*, "*etc.*" and "*km*". Furthermore, certain words are underlined to emphasise importance, such as "*acquired*" and "*accurate records of qualifying kilometres*".

The fact that a taxpayer has incurred an expense that is of the nature prescribed by the Commissioner is not sufficient to secure the applicable tax relief; it is further required that the expense is necessarily incurred and paid by the taxpayer in consequence of any physical impairment or "disability" suffered by the taxpayer, his or her spouse or child, or any dependant of the taxpayer. For example, whilst the Commissioner has prescribed "*note-taking services*" as a qualifying expense, expenditure incurred in respect such services will only be allowable if the additional requirements are also satisfied.

The media release that accompanied the first issue of the prescribed list states that "*although the list of qualifying expenses is quite extensive, care has been taken to ensure that it does not*

exclude a legitimate expense that is not listed. Therefore, instead of a comprehensive list, it identifies broad categories of qualifying expenses and provides examples of expenditure that could be claimed" (SARS, 2010a:1). It should be noted that such statement is not included in the prescribed list itself and that a media release has no evidential weighting. Furthermore, it is not clear what is meant by "*care has been taken*" with regard to ensuring that items are not excluded. A strict interpretation of the inclusion of the words "*prescribed by the Commissioner*" in paragraph (c) of the definition of "qualifying medical expenses" would conclude that if an expense item cannot meet any of the descriptions or examples included in the relevant document issued by SARS, such expenditure is not prescribed and thus should not qualify, regardless of whether or not it was incurred in consequence of a physical impairment or "disability".

Section 4(1)(a)(i) of the South African Revenue Services Act, No. 34 of 1997, states that "*SARS must secure the efficient and effective, and widest possible enforcement of the national legislation listed in schedule 1*". The Income Tax Act is one such listed statute and is thus one of several acts that the Commissioner is charged with administering. In terms of section 2 of the Income Tax Act, "*the Commissioner is responsible for carrying out the provisions of this Act*". It is therefore clear that the Commissioner has been charged with the responsibility of enforcing the provisions of the Income Tax Act. By publishing a list of qualifying expenditure items, the Commissioner has acted in accordance with legislation. It is submitted that paragraph (c) of the definition of "qualifying medical expenses" has in essence provided the Commissioner with the authority to "legislate" what specific expenditure items qualify for the applicable relief. By including the words "*prescribed by the Commissioner*" the legislation effectively grants the Commissioner the power to write the rules that will be enforced by SARS. It is submitted that the legislator should not grant the Commissioner the authority to dictate the rules that the Commissioner is charged with enforcing and a recommended amendment to the legislation in this regard will be discussed in Chapter Four.

"necessarily incurred" and "in consequence of"

In order for a prescribed expense to be meet the requirements of paragraph (c) of the definition of "qualifying medical expenses" such expense must be necessarily incurred and paid by the taxpayer in consequence of any physical impairment or "disability" suffered by the taxpayer, his or her spouse or child, or any dependant of the taxpayer. The terms "*necessarily incurred*" and "*in consequence of*" are not defined in the Income Tax Act and

thus it is necessary to rely on their ordinary meaning as well as applicable interpretations as found in case law.

The word "necessarily" is defined by the Merriam-Webster Dictionary (2013: online) as "*of necessity*" and is described as an adverb which is "*used to say that something is necessary and cannot be changed or avoided*". The same dictionary defines "incurred" as "*to become liable or subject to*". Thus, in the context of paragraph (c) of the definition of "qualifying medical expenses" and given the ordinary meaning of the words, "*necessarily incurred*" could be interpreted such that the legislation requires the taxpayer to have been liable for such expenditure as a matter of necessity due to unavoidable circumstances. To give full meaning to the words it is necessary to examine them in conjunction with "*in consequence of*". According to the Merriam-Webster Dictionary (2013: online), "in consequence" means "*as a result*". Therefore, taking the ordinary meanings of the two terms, in the context of paragraph (c) of the definition of "qualifying medical expenses" "*necessarily incurred*" and "*in consequence of*" can be interpreted such that the paragraph requires that the taxpayer was liable for the prescribed expenditure as a matter of necessity as a result of a physical impairment or "disability". In simple terms, based on the ordinary meaning of the terms, the physical impairment or "disability" should necessitate the expenditure in question. This interpretation is in line with that found in the SARS guide, which states that "*the expense must be necessary and incurred as a result of a physical impairment* [or disability]" (SARS, 2014:12). A further SARS interpretation can be found in the prescribed list where it is stated that "*the expense must also be necessary for the alleviation of the restrictions on a person's ability to perform daily functions*". It is submitted that this interpretation could be regarded as being narrow and limiting. For example, if a person who has a disability that restricts their mobility pays for the insurance of their motorised wheelchair, such insurance expense would not have been incurred in order to alleviate the restriction on the person's ability to perform daily functions, however, it can be said that such expense arose as a result of the person's disability. Thus, the insurance expense could qualify on the basis of the interpretation that the expense is necessary as a result of the disability; however, it would probably not be allowable if the narrow interpretation is enforced that, as it is not necessary for the insurance to alleviate the restrictions placed on the person's ability to perform daily functions, it would not be deductible.

The principle of an expenditure item only qualifying if it is incurred in consequence of a second element is not uncommon in tax legislation. The most noteworthy example is to be

found in section 11(a) of the Income Tax Act which permits a deduction of expenditure only if it incurred "*in the production of income*". Regardless of whether the requirement of the relevant paragraph is that the expense should be incurred "*in the production of income*" or "*in consequence of a physical impairment or disability*", a similarity in the principle exists because in both instances it is required that there be a causal link between the expenditure being incurred and a second element. This similarity in principle means that the case law which is applicable to the interpretation of "*in the production of income*" can be useful in interpreting the meaning of "*in consequence of a physical impairment or disability*".

In the case of *Port Elizabeth Electric Tramway Co Ltd v CIR* (1936 CPD 241) (8 SATC 13), in his judgement, Watermeyer AJP said:

> The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible…
>
> The other question is, what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it.

In the context of expenditure incurred "*in consequence of a physical impairment or disability*" it is possible to highlight the same principle; the need for a causal link. In a similar manner it can be said that an action is attached to an expense and that if such action is performed in consequence of a physical impairment or "disability" then that expenditure attached to the action should be qualifying expenditure. A similar question can be posed; that is, how closely must the expense be linked to an action that was done in consequence of a physical impairment or "disability"? The crucial requirement is that the expense should be so closely connected to an action that was undertaken in consequence of the physical impairment or "disability" that it can be regarded as being a cost of performing that action. From the case of *COT v Rendle* (1965(1) SA 59 (SRAD) (26 SATC 326)) it is possible to extract the principle that if the risk or chance of an expense being incurred is an inevitable or necessary concomitant of the taxpayer's business operations then such expense is incurred in the production of income. Expenditure should then be regarded as being incurred "*in*

consequence of a physical impairment or disability" if the risk or chance of that expenditure being incurred is an inevitable or necessary concomitant of the person's physical impairment or "disability".

A common theme to be found in all of the above interpretations of the terms "*necessarily incurred*" and "*in consequence of a physical impairment or disability*" is that the expense must be necessary or needed because of the physical impairment or "disability". This means that the expense could be disallowed on the grounds of the expenditure being regarded as unnecessary or excessive. There are certain situations which can be resolved using an objective approach; for example, it is clear that the acquisition of an air conditioner by a person whose only disability relates to his or her hearing would not be regarded as expenditure that was necessarily incurred in consequence of that person's hearing disability. It is submitted, however, that an argument in support of a particular type of expenditure is almost certainly likely to be a subjective one. For example, a parent of a child who has been diagnosed with autism might have been advised that a diet that excludes gluten could assist in improving autism symptoms. From the parent's point of view, any expenditure that is incurred to acquire gluten-free products for their autistic child would be necessary as it is reasonable to assume that a parent would regard any expenditure that could result in the alleviation of their child's affliction as being necessary. However, there are experts, including Dr Jay Hoecker (2011: online), who are of the opinion that there is little evidence that a restriction of gluten improves autism symptoms. Accordingly, it could be argued that the gluten-free diet expenditure incurred by the parents of an autistic child is not necessary and thus the subjective/objective debate clouds the issue.

Whether or not expenditure could be regarded as being excessive also requires a subjective approach. For example, the prescribed list allows for the travelling expenses (including flights and accommodation) paid in respect of a care attendant who has accompanied a person with a "disability", where such person is away from their primary residence. If a wealthy person who is blind were to travel overseas accompanied by a care attendant and that person paid for first-class air fares and five-star hotel accommodation for the assistant as that is what that person is accustomed to, then such expenditure should not be regarded as being excessive. In relation to excessive expenditure, in the case of *Tobacco Father v COT* (1951 SR) (17 SATC 395) the court held that it is not for the Commissioner or for the Courts to decide what a reasonable wage is in a particular industry and that each industry must decide for itself what a fair rate of wage is. If this principle is applied in the context of expenditure

relating to physical impairments or disabilities, then it could be said that the measure of whether or not such expenditure should be regarded as being excessive should be determined by assessing what is regarded as reasonable based on what other taxpayers in similar circumstances expend. The principle of determining what is considered to be reasonable by comparing the extent of the expense in comparison to what other taxpayers in similar circumstances spend can also be found in the *Port Elizabeth Electric Tramways Co Ltd* case. A determination of what is regarded as "reasonable" will naturally require a subjective approach and it should be borne in mind that a person entitled to the applicable tax relief is most likely to regard any expenditure that has the potential to alleviate the afflictions of a physical impairment or "disability" as being necessary and not excessive.

The following is a proposal in respect of the interpretation of the terms "*necessarily incurred*" and "*in consequence of*" in the context of paragraph (c) of the definition of "qualifying medical expenses":

- the physical impairment or "disability" should necessitate the expense (based on the ordinary meanings of the terms as taken from the Merriam-Webster Dictionary);
- the expense must be necessary and incurred as a result of a physical impairment [or "disability"] (based on an interpretation in the SARS guide);
- the expense must be necessary for the alleviation of the restrictions on a person's ability to perform daily functions (based on an interpretation in the prescribed list);
- the expense should be so closely connected to an action that was undertaken in consequence of the physical impairment or "disability" that it can be regarded as being a cost of performing that action (based on similar principles in the case of *Port Elizabeth Electric Tramway Co Ltd)*;
- the risk or chance of that expenditure being incurred should be an inevitable or necessary concomitant of the physical impairment or "disability" (based on similar principles in the case of *Rendle)*; and
- whether expenditure incurred in consequence of a physical impairment or "disability" should be regarded as being excessive should be determined by assessing what is regarded as reasonable based on what other persons in similar circumstances expend (based on similar principles in the case of *Port Elizabeth Electric Tramway Co Ltd).*

If an expense is to meet the requirements of paragraph (c) of the definition of "qualifying medical expenses" such expense must be paid in consequence of physical impairment or "disability" suffered by the taxpayer, his or her spouse or child, or any dependant of the taxpayer. Accordingly, the previous discussion of the section 6B(1) definition of "disability" is applicable when considering the application of paragraph (c) of the definition of "qualifying medical expenses". As pointed out in that discussion, the Income Tax Act does not include a definition of "physical impairment".

2.4.5 Section 6B(2)

In terms of section 6B(2), "*a rebate, to be known as the additional medical expenses tax credit, must be deducted from the normal tax payable by a person who is a natural person.*"

Section 6B declares that there is an additional medical expenses tax credit and that such credit will reduce the normal tax payable by a natural person taxpayer. Where the additional medical expenses credit exceeds the tax liability of the taxpayer, the excess amount is lost. Section 6B(3) determines the amount of such credit based on factors such as a person's age or whether or not the taxpayer or someone in their immediate family is a person with a physical impairment or a person diagnosed as having a "disability" as defined.

2.4.6 Section 6B(3)

In terms of section 6B(3)(a):

> The amount of the additional medical expenses tax credit must be where the person is entitled to a rebate under section 6(2)(b), the aggregate of-
>
> i) 33,3 per cent of so much of the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as exceeds three times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and
>
> ii) 33,3 per cent of the amount of qualifying medical expenses paid by the person . . .

Section 6B(3)(a) is only applicable to a taxpayer who is entitled to a rebate under section 6(2)(b). Accordingly, section 6B(3)(a) will only apply to a taxpayer who was or, had he or she lived, would have been 65 years of age or older on the last day of the year of assessment.

Previously, under section 18(2)(a), this group of taxpayers were entitled to a tax deduction in respect of all medical scheme contributions and all qualifying medical expenses. Owing to the fact that all medical scheme contributions were tax deductible for this group of taxpayers, they did not receive a medical scheme fees tax credit as contemplated in section 6A.

From the commencement of the 2015 year of assessment, taxpayers who are 65 years or older on the last day of the tax year, will be entitled to a tax credit equal to 33.3% of the sum of qualifying medical expenses as defined in section 6B(1) and the medical scheme contributions in excess of three times the medical scheme fees tax credit to which that taxpayer is entitled to under section 6A(2)(b).

The effect of changing from a deduction for qualifying medical expenses and excess medical scheme contributions will be discussed in more detail below, however, it should be noted that, from the 2015 year of assessment onwards, taxpayers who are 65 years or older on the last day of the tax year have moved from a pure medical deduction system to a pure medical credit system, whereas all other taxpayers are moving to the pure medical credit system from a position where they previously had a medical deduction and a medical scheme fees tax credit.

In terms of section 6B(3)(b),

> The amount of the additional medical expenses tax credit must be where the person, his or her spouse or his or her child is a person with a disability, the aggregate of-
>
> i) 33,3 per cent of so much of the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as exceeds three times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and
>
> ii) 33,3 per cent of the amount of qualifying medical expenses paid by the person . . .

Section 6B(3)(b) will only apply to a taxpayer who has been diagnosed with a “disability” as defined in section 6B(1) or where the taxpayer’s spouse or child is a person with such “disability”. This group of taxpayers is entitled to a tax credit that is calculated in the same manner as that which is granted to taxpayers who are 65 years or older on the last day of the year of assessment.

Notwithstanding the duplication, it is acknowledged that the legislature may have elected to separate the provisions applicable to these two groups of taxpayers so that a distinction can be made between them should future amendments be considered which provide for different levels of relief for each group. It should also be noted that non-medical expenses incurred by a person who is over the age of 65 in consequence of any physical impairment or "disability" suffered by the person or any dependant of the person should entitle such person to a section 6B(3)(a) additional medical expense tax credit without that person being required to provide the Commissioner with the prescribed ITR-DD form. It is a requirement of section 6B(3)(b) that the person or their dependant is a person with a "disability" in order to receive the relief envisaged in that section, however, the only qualifying requirement for section 6B(3)(a) is that the person must be 65 years or older on the last day of the year of assessment. Accordingly, the removal of this burden of proof of diagnosis of "disability" for taxpayers older than 65 years of age appears to be a further reason for the distinction between subparagraphs (a) and (b) of section 6B(3), despite the relief being calculated in the same manner.

For the 2013 and 2014 years of assessment, section 18(2)(b)(ii) determined the extent to which excess medical scheme contributions could be taken into account by a taxpayer who has a "disability" as defined or whose child or spouse has such "disability". This section allowed a taxpayer a deduction equal to

> so much of the contributions made by the taxpayer as contemplated in subsection (1)(a) as exceeds four times the amount of the medical scheme fees tax credit in respect of that taxpayer in terms of section 6A.

Accordingly, previously, the tax relief that would arise from excess medical scheme fees would be so much of those contributions as exceeds four times the taxpayer's medical scheme fees tax credit, multiplied by the marginal tax rate applicable to the taxpayer's taxable income as per the tax tables.

The tax relief afforded to a taxpayer from the commencement of the 2015 year of assessment in respect of excess medical scheme fees is so much of those contributions as exceeds three times the taxpayer's medical scheme fees tax credit, multiplied by 33.3%.

At first glance, a taxpayer whose applicable marginal tax rate is greater than 33.3% appears to be receiving more tax relief than before because the medical scheme fees tax credit is only

multiplied by three, instead of four, when determining the extent to which the medical scheme contributions may be taken into account, however, the relief in fact remains at a similar level due to the fact that the qualifying excess is only multiplied by 33.3% instead of their higher marginal tax rate. This multiplication factor of three instead of four ensures that taxpayers who have a marginal tax rate of higher than 33.3% do not receive any less tax relief in respect of their medical scheme contributions when compared to the repealed section 18 provisions. Accordingly, the perceived increase in tax relief owing to the multiplication factor changing from four to three is set off by the change whereby the excess is multiplied by 33.3% instead of the taxpayer's higher marginal tax rate. Figure 1 below illustrates that taxpayers with a marginal tax rate of greater than 33.3% should receive a similar level of tax relief under section 6B in respect of their excess medical scheme contributions when compared to the repealed section 18.

For taxpayers who have an applicable marginal tax rate that is less than 33.3%, the available tax relief has increased by a noticeable amount due to the multiplication factor of three, instead of four, as well as the increased rate of relief.

Figure 1 below illustrates the different tax relief created by the repealed section 18(2)(b)(ii) and the new section 6B(3)(i) in respect of excess medical scheme contributions. It is important to note that this graph does not take into account the tax relief provided by the section 6A medical scheme fees tax credit. In generating the data for this graph, the following assumptions were made:

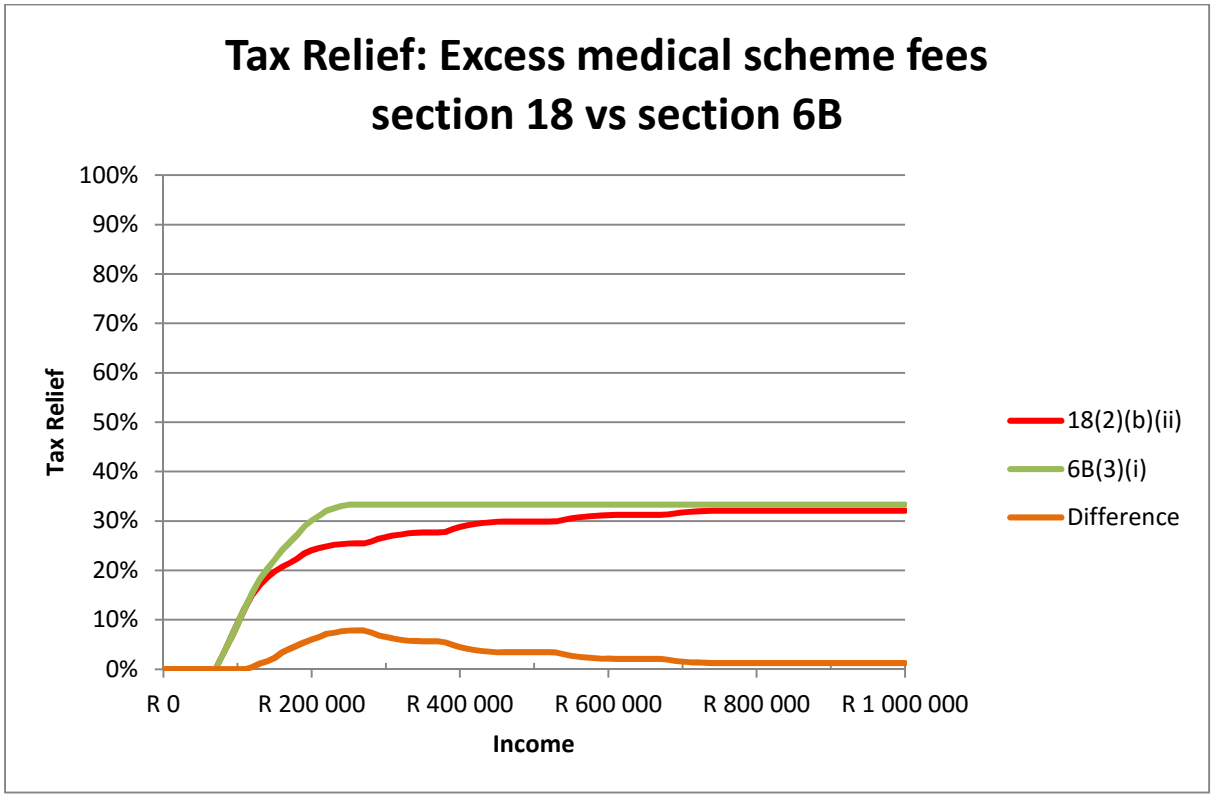
- The taxpayer or the taxpayer's spouse or child is person with a "disability";
- Although section 18 is not applicable to the 2015 year of assessment, for comparative purposes, the tax tables, the primary rebate and the medical scheme fees tax credit for that year of assessment are used;
- The taxpayer is younger than 65 years of age;
- The taxpayer is a member of a medical scheme which provides benefits for himself and two dependants – the total medical scheme contributions for the 12 months of membership amounts to R110 000;
- The taxpayer has a single source of income – his or her salary;
- The taxpayer has no other tax deductions to take into account – the only tax deduction for the taxpayer is the section 18(2)(b)(ii) deduction and this is only in respect of

medical scheme contributions which exceed four times the section 6A medical scheme fees credit to which the taxpayer is entitled; and

- The taxpayer has no out-of-pocket medical expenditure or expenses incurred in consequence of a "disability".

In the case of the section 18(2)(b)(ii) deduction, the medical scheme contributions paid by the taxpayer which exceed four times the section 6A medical scheme fees tax credit to which the taxpayer is entitled are multiplied by the taxpayer's marginal tax rate to arrive at the tax relief. This tax relief is then divided by the total contributions made by the taxpayer to determine, as a percentage, the tax relief in respect of those contributions. As noted above, the graph does not take into account the tax relief provided for in section 6A. The same principle was applied in the case of the section 6B additional medical expenses tax credit, except that the medical scheme contributions paid by the taxpayer which exceed three times the taxpayer's section 6A medical scheme fees tax credit are multiplied by 33.3% and not the taxpayer's marginal tax rate. This multiplication factor of three instead of four ensures that taxpayers who have a marginal tax rate of higher than 33.3% do not receive any less tax relief in respect of their medical scheme contributions when compared to the repealed section 18 provisions. It is demonstrated in Figure 2 that the relief provided by section 18 and section 6B differs in respect of the tax relief available in relation to out-of-pocket medical expenditure and expenditure incurred and paid in consequence of a "disability".

Figure 1 Tax Relief: Excess medical scheme fees - section 18 vs section 6B



The graph shows that the section 6B(3)(i) relief in respect of excess contributions should not provide any less relief for taxpayers with an applicable marginal tax rate which is greater than 33.3% and that taxpayers at a marginal tax rate that is lower than 33.3% should receive greater tax relief compared to the previous legislation.

Prior to the commencement of the 2015 tax year, section 18(2)(b)(i) allowed a taxpayer with a "disability" as defined, or whose child or spouse who had such "disability", a deduction in respect of certain medical and disability-related expenditure not recovered from the medical scheme. The medical and disability-related expenditure that could be taken into account is essentially the same as that contemplated in the definition of "qualifying medical expenses" for the purposes of section 6B. The tax relief available to the taxpayer in terms of section 18(2)(b)(i) was equal to the sum of such expenditure multiplied by the taxpayer's applicable marginal tax rate.

From the start of the 2015 year of assessment, the tax relief available to taxpayers who are disabled or whose spouse or child is disabled is equal to 33.3% of the taxpayer's "qualifying medical expenses" as defined; this relief is in terms of the provisions of section 6B(3)(b)(ii).

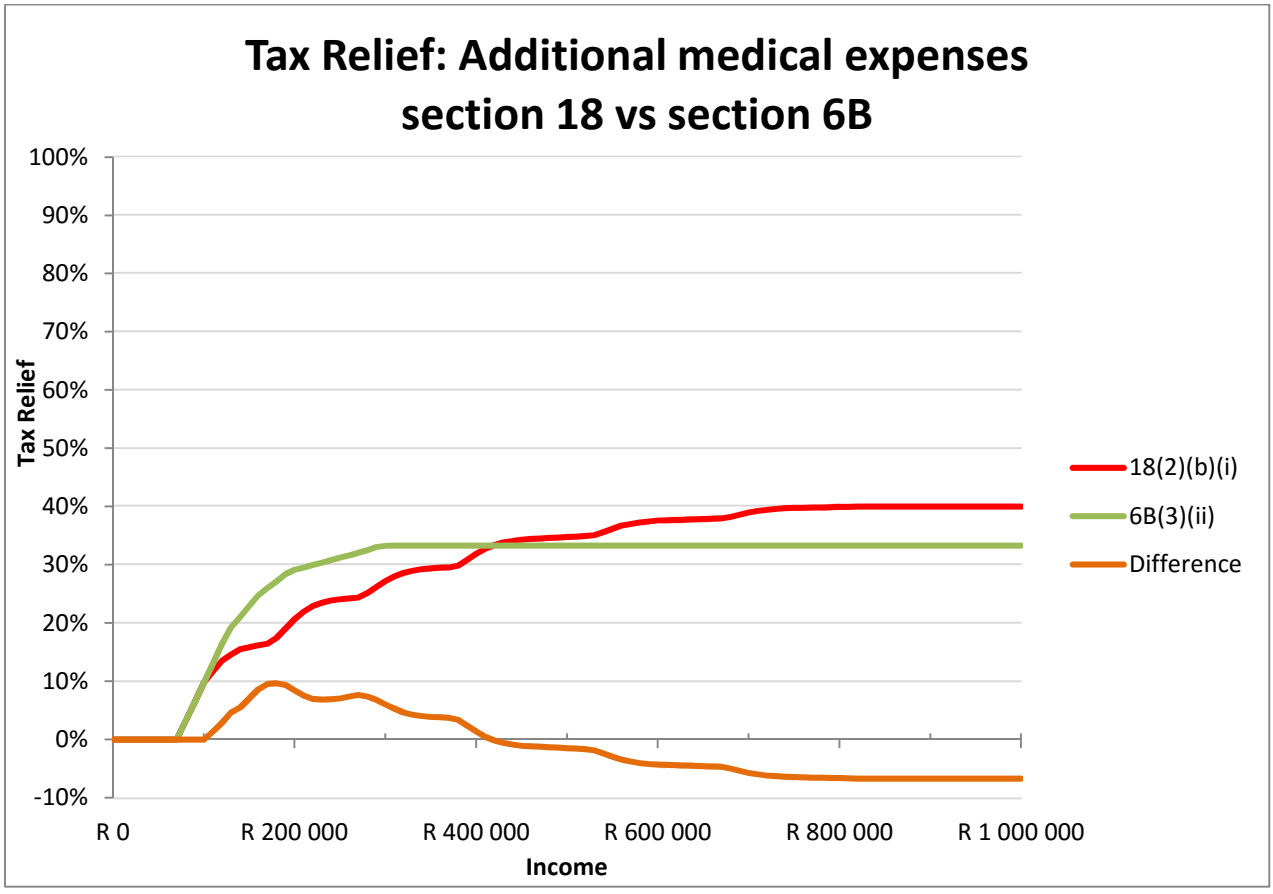
Figure 2 below illustrates the difference between the tax relief afforded to taxpayers where there is a "disability" in the family under the former section 18(2)(b)(i) compared to that of section 6B(3)(b)(ii). In generating the data for this graph, the following assumptions were made:

- The taxpayer or the taxpayer's spouse or child is person with a "disability";
- Although section 18 is not applicable to the 2015 year of assessment, for comparative purposes, the tax tables and the primary rebate for that year of assessment are used;
- The taxpayer is younger than 65 years of age;
- The taxpayer is not a member of a medical scheme – the taxpayer paid no fees to a medical scheme and thus is not entitled to any section 6A medical scheme tax credit;
- The taxpayer has a single source of income – his or her salary;
- The taxpayer has no other tax deductions to take into account – the only tax deduction for the taxpayer is the section 18(2)(b)(ii) deduction and this is only in respect of out-of-pocket medical expenditure and expenditure incurred in consequence of a "disability"; and
- The taxpayer's out-of-pocket medical expenditure and expenditure incurred in consequence of a "disability" amounts to R150 000 for the year of assessment.

In the case of the section 18(2)(b)(i) deduction, the out-of-pocket medical expenditure and the expenditure incurred in consequence of a "disability" is multiplied by the taxpayer's marginal tax rate to arrive at the tax relief. This tax relief is then divided by the total out-of-pocket medical expenditure and expenditure incurred in consequence of a "disability" to determine, as a percentage, the tax relief in respect of that expenditure. The same principle was applied in the case of the section 6B additional medical expenses tax credit, except that the expenditure was multiplied by 33.3% and not the taxpayer's marginal tax rate. Owing to the fact that a fixed percentage is used instead of the taxpayer's marginal tax rate, a taxpayer who has a marginal tax rate that is higher than 33.3% should receive less tax relief per Rand spent on out-of-pocket medical expenditure and disability-related expenses under section 6B when compared to the relief provided in terms of section 18(2)(i). Where a taxpayer has a marginal tax rate that is lower than 33.3%, the taxpayer should receive more relief per Rand of out-of-pocket medical and disability-related expenditure under section 6B when compared to section 18(2)(i) relief.

It should be noted that a taxpayer who has an assessed loss or whose tax liability is less than 33.3% of their section 6B qualifying medical expenditure, could find themselves receiving limited tax relief under section 6B when compared to section 18 as there is no opportunity under section 6B for a roll-over of the credit to a future year of assessment; in contrast a section 18 deduction could contribute to an assessed loss for the taxpayer. If a taxpayer is in such situation, it is possible that the taxpayer is entitled to none or only part of the section 6A medical schemes tax credit. If the taxpayer is in an assessed loss position before considering the primary rebate, then neither the primary rebate nor the section 6A credit will be applicable. Once a taxpayer has fully utilised the primary rebate, the section 6A medical scheme fees tax credit may then be brought into account, but only to the extent that the tax liability is reduced to zero. In such situations, the taxpayer will not be able to utilise a section 6B tax credit as there is no tax liability to reduce. Accordingly, taxpayers with relatively low income could find themselves receiving little or no Income Tax relief in respect of the medical scheme contributions and/or qualifying medical expenses. This was not the case under section 18 which, as a tax deduction, could give rise to an assessed loss for the taxpayer to provide relief in the following year of assessment.

Figure 2 Additional medical expenses - section 18 vs section 6B



It is apparent from the graph that taxpayers with an applicable marginal tax rate that is higher than 33.3% receive less tax relief under section 6B(3)(b)(ii) than they did when the repealed section 18(2)(b)(i) applied. It is also clear that most taxpayers faced with a marginal tax rate of lower than 33.3% receive significantly greater tax relief from the provisions of section 6B(3)(b)(ii) when compared to the previous legislation.

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012, notes that the conversion from a deduction to a credit "*was based on the notion that medical tax credits provide a more equitable form of relief than medical deductions because the relative value of the relief does not increase with higher income levels*" (National Treasury: 2012). Whilst it may seem unfair that higher income taxpayers are receiving less relief than before and that lower income taxpayers will enjoy increased relief, the argument presented by National Treasury in the Explanatory Memorandum is that the deduction system did not provide for equitable relief and that the move to a credit system will correct this problem (National Treasury: 2012). Previously, a taxpayer in the highest income bracket who was entitled to the disability tax relief would receive relief equal to 40 cents for every Rand spent on qualifying medical expenses, whilst a taxpayer in the lowest bracket would receive only 18 cents for each Rand spent on such expenditure. It can be argued that a taxpayer with a higher level of income requires less relief than a person with a lower income. Accordingly, despite the decreased tax relief for high-income taxpayers and low-income taxpayers receiving greater relief, all taxpayers now receive relief at the same rate and it is submitted that this produces a more equitable result.

Whilst this discussion mentions high-income taxpayers receiving less tax relief than before and low-income taxpayers seeing an increase in their relief, taxpayers with a high level of income are still more likely to obtain a higher amount of relief than a low-income taxpayer, based on the assumption that a higher earner will spend more on medical and disability-related expenses. For example, a disabled taxpayer in the highest income bracket might spend R100 000 on qualifying medical expenses and receive R33 300 in tax relief, whilst a low-income taxpayer, suffering from the same disability, might only spend R10 000 on such expenses and receive tax relief of R3 330. Previously the same higher income taxpayer, assuming such taxpayer is taxed at the marginal rate of 40%, would have received R40 000 relief, whilst the lower earner, assuming that such taxpayer is taxed at the marginal rate of 18%, would have received only R1 800. In this example, under the new legislation, the higher

earning taxpayer has had their tax relief reduced by 16.75%, whilst the lower earning taxpayer has had their relief increased by 85%.

It is important to note that section 6B(3)(b) is not applicable to a taxpayer who does not have, or whose spouse or child does not have, a physical impairment or "disability". It is also not applicable to a taxpayer who has a physical impairment, but one that does not meet the definition of a "disability", or to a taxpayer who has a spouse or child with such non-qualifying physical impairment; in such circumstances, section 6B(3)(c) will apply.

Section 6B(3)(c) is applicable to taxpayers under the age of 65 and who do not have a "disability" as defined or who do not have a spouse or child with such "disability". Accordingly, section 6B(3)(c) will also be applicable in the case of persons who have a physical impairment that does not meet the qualifying criteria of a "disability" as defined. It is also applicable where the taxpayer's dependant, who is not their spouse or child, is a person with a "disability" as defined; for example, where a taxpayer's disabled parent is their dependant.

In terms of section 6B(3)(c),

> The amount of the additional medical expenses tax credit must be in any other case, 25 per cent of so much of the aggregate of-
>
> i) the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as exceeds four times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and
>
> ii) the amount of qualifying medical expenses paid by the person,
>
> as exceeds 7,5 per cent of the person's taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit).

A taxpayer who does not have a "disability" as defined and who does not have a spouse or child with a "disability", is entitled to a tax credit equal to 25% of so much of the sum of, their medical scheme contributions that exceed four times their medical scheme fees tax credit and so much of their "qualifying medical expenses", as exceeds 7.5% of their taxable income. Where a taxpayer has incurred expenditure in consequence of a physical impairment, such expenditure is included in their "qualifying medical expenses".

If a taxpayer has a dependant who is not their spouse or child and that dependant is a person with a "disability" as defined, the taxpayer will only be entitled to the relief contemplated in section 6B(3)(c) and not that contained in section 6B(3)(b). An example of such a scenario is where a taxpayer incurs expenditure in consequence of his or her parent's "disability".

The table below illustrates by way of example the varying degree of tax relief available under section 6B(3)(b) compared to that under section 6B(3)(c) for the 2015 year of assessment. Section 6B(3)(b) is applicable where the taxpayer, his or her spouse, or his or her child is a person with a "disability". Section 6B(3)(b) is applicable where the taxpayer is 65 years of age on the last day of the applicable year of assessment. As mentioned above, the relief available in terms of the provisions of section 6B(3)(a) is the same as that afforded by section 6B(3)(b). Accordingly, the section 6B(3)(a) relief has been omitted from the table below as the calculation will be the same as section 6B(3)(b). Section 6B(3)(c) is applicable where the taxpayer is younger than 65 years of age on the last day of the applicable year of assessment and where the taxpayer, his or her spouse, or his or her child is not a person with a "disability". Section 6B(3)(c) is also applicable where the taxpayer, his or her spouse, or his or her child is a person with a physical impairment (and not a "disability"). The table illustrates the lesser relief afforded to taxpayers not qualifying for either the section 6B(3)(b) or section 6B(3)(a) tax relief. In the example, both taxpayers are principal members of a medical scheme with three dependants. The taxpayer entitled to the section 6B(3)(b) tax relief has a child with a "disability" as defined. The taxpayer entitled to the section 6B(3)(c) tax relief has a child with a physical impairment. All persons in the example are under the age of 65.

Table 3 Section 6B tax relief: Physical impairment vs "disability"

	Ref	Section 6B(3)(b)	Section 6B(3)(c)
Taxable Income	(a)	1 000 000	1 000 000
Medical scheme fees	(b)	86 400	86 400
Qualifying medical expenses	(c)	85 000	85 000
Medical scheme fees tax credit	(d)	10 296	10 296
Four times medical scheme fees tax credit	(e)	n/a	41 184
Three times medical scheme fees tax credit	(f)	30 888	n/a
7.5% of taxable income – (a) multiplied by 7.5%	(g)	n/a	75 000

Expenses to be taken into account – (b) less (f) plus (c)	(h)	140 512	n/a
Expenses to be taken into account – (b) less (e) plus (c) less (g)	(i)	n/a	55 216
Additional medical expenses tax credit – (h) multiplied by 33.3%		46 791	n/a
Additional medical expenses tax credit – (i) multiplied by 25%		n/a	13 804

In the above example, the two taxpayers have the same level of taxable income, the same medical scheme contributions and the same qualifying medical expenses. The taxpayer whose child has a physical impairment (as opposed to a "disability" as defined), receives less tax relief because of three factors:

- The medical schemes fees tax credit is multiplied by four instead of three when determining the extent to which the medical scheme contributions may be taken into account;
- The expenses can only be taken into account to the extent that they in aggregate exceed 7.5% of the taxpayer's taxable income; and
- Once the amount of the expenses that can be taken into account has been determined, only 25% of such amount results in a tax credit. In the case of the taxpayer who has a child with a "disability" as defined, the tax credit is 33.3% of the expenses that can be taken into account.

2.4.7 Section 6B(4)

In terms of section 6B(4), for the purposes of section 6B,

> any amount contemplated in subsection (3) or the definition of 'qualifying medical expenses' that has been paid by—
>
> (a) the estate of a deceased person is deemed to have been paid by the person on the day before his or her death; or

(b) an employer of the person is, to the extent that the amount has been included in the income of that person as a taxable benefit in terms of the Seventh Schedule, be deemed to have been paid by that person.

Section 6B(4)(a) is similar to section 6A(3)(a) which deems medical scheme fees that have been paid by the estate of a deceased person to have been paid by the taxpayer on the day before his or her death. Section 6B(4)(a) deems any excess medical scheme fees as contemplated in section 6B(3) and any "qualifying medical expenses" as defined in section 6B(4) to have been paid by the taxpayer on the day before his or her death if such expenditure has been paid by his or her estate.

Paragraph (b) of section 6B(4) is also similar to section 6A(3)(b) which deems any medical scheme fees paid by a taxpayer's employer to have been paid by the taxpayer, to the extent that such amount has been included in the gross income of the taxpayer as a taxable fringe benefit. Section 6B(4)(b) deems any excess medical scheme fees as contemplated in section 6B(3) and any "qualifying medical expenses" as defined in section 6B(4) to have been paid by the taxpayer to the extent that those expenses have been included in the taxpayer's gross income as a taxable fringe benefit.

In terms of paragraph 2(i) of the Seventh Schedule to the Income Tax Act, a taxable benefit arises where

> the employer has during any period directly or indirectly made any contribution or payment to any fund contemplated in paragraph (b) of the definition of "benefit fund" in section 1 for the benefit of any employee or the dependants of any employee.

Paragraph (b) of the definition of "benefit fund" as contained in section 1 of the Income Tax Act specifically includes *"any medical scheme registered under the provisions of the Medical Schemes Act."*

Paragraph 12A(1) of the Seventh Schedule determines the cash equivalent of a paragraph 2(i) benefit to be

> the amount of any contribution or payment made by the employer in respect of a year of assessment, directly or indirectly, to any medical scheme registered under the Medical Schemes Act or to any fund which is registered under any similar provision contained in the

> laws of any other country where the medical scheme is registered, for the benefit of any employee or dependants, as defined in that Act, of that employee.

Accordingly, an amount equal to the contributions made by the employer to a medical scheme for the benefit of any employee or the employee's dependants will be included in the taxpayer's gross income.

In terms of paragraph 2(j) of the Seventh Schedule to the Income Tax Act, a taxable benefit arises where

> the employer has, directly or indirectly, incurred any amount (other than a contribution or payment contemplated in item (i)) in respect of any medical, dental and similar services, hospital services nursing services or medicines provided to the employee or his or her spouse, child, relative or dependant.

Paragraph 12B(1) of the Seventh Schedule determines the cash equivalent of a paragraph 2(j) benefit to be

> the amount incurred by the employer during any month, directly or indirectly, in respect of any medical, dental and similar services, hospital services, nursing services or medicines in respect of that employee, his or her spouse, child or other relative or dependants.

Any amount incurred by an employer in respect of such medical expenses will be included in the taxpayer's gross income. It should be noted that in order for a medical scheme contribution to fall within the net of the Seventh Schedule it is necessary for the employer to have made a contribution or payment to a medical scheme, however, a medical expense will be included as a fringe benefit as soon as that expense has been incurred by the employer.

In most instances, medical scheme fees and other medical expenses paid by an employer for the benefit of the employee or his dependants will be considered a taxable benefit and thus the provisions of section 6B(4) would be applicable. There are, however, certain employee benefits that are considered to be non-taxable and in those instances section 6B(4) will not apply.

In terms of paragraph 12A(5) of the Seventh Schedule, no value is placed on medical scheme contributions paid by an employer when the benefit is derived by

(a) a person who by reason of superannuation, ill-health or other infirmity retired from the employ of such employer; or

(b) the dependants of a person after such person's death, if such person was in the employ of such employer on the date of death; or

(c) the dependants of a person after such person's death, if such person retired from the employ of such employer by reason of superannuation, ill-health or other infirmity.

From 1 March 2006 to 28 February 2012, no value was placed on medical scheme contributions paid by an employer when the benefit was derived by a person who during the relevant year of assessment was entitled to a rebate under section 6(2)(b); that is a person who was or, had he or she lived, would have been 65 years of age or older on the last day of the year of assessment. As of 1 March 2012, this group of taxpayers will now have such benefit included in their gross income.

In terms of paragraph 12B(3) of the Seventh Schedule, no value is placed on any taxable benefit as contemplated in paragraph 2(j) of that Schedule

(a) resulting from the provision of medical treatment listed in any category of the prescribed minimum benefits determined by the Minister of Health in terms of section 67(1)(g) of the Medical Schemes Act which is provided to the employee or his or her spouse of children in terms of a scheme a programme of that employer –

(i) which constitutes the carrying on of the business of a medical scheme if that scheme or programme has been approved by the Registrar of Medical Schemes as being exempt from complying with the requirements of medical schemes in terms of that Act; or

(ii) which does not constitute the carrying on of the business of a medical scheme, if that employee and his or her spouse and children –

(aa) are not beneficiaries of a medical scheme registered under the Medical Schemes Act; or

(bb) are beneficiaries of such a medical scheme, and the total cost that treatment is recovered from that medical scheme;

(aA) where the services are rendered or the medicines are supplies for the purposes of complying with any law of the Republic.

(b) derived from an employer by –

(i) a person who by reason of superannuation, ill-health or other infirmity retired from the employ of that employer;

(ii) the dependants of a person after that person's death, if that person was in the employ of that employer on the date of death;

(iii) the dependants of a person after that person's death, if that person retired from the employ of that person by reason of superannuation, ill-health or other infirmity;

(iv) a person who during the relevant year of assessment is entitled to a rebate under section 6(2)(b); or

(c) where the services are rendered by the employer to its employees in general at their place of work for the better performance of their duties.

As noted above, as of 1 March 2012, an employee who was or, had he or she lived, would have been 65 years of age or older on the last day of the year of assessment, receives a taxable benefit if the employer contributes to a medical scheme for the benefit of the employee or the dependants of the employee; previously no value was placed on such benefit. Notwithstanding this amendment, there has been no change to the provisions of paragraph 12B(3)(b)(iv) of the Seventh Schedule which provide that no benefit is placed on any benefit derived by an employee in this age group from their employer in respect of any medical, dental and similar services, hospital services, nursing services or medicines provided to the employee or his or her spouse, child, relative or dependant.

Paragraph 12B(3) of the Seventh Schedule also ensures that no value is placed on any such medical benefit derived by a person from their employer following their retirement by reason of superannuation, ill-health or other infirmity, or by the person's dependants after their death if they retired from the employ of that employer for the same reasons, or by a person's dependants after their death if that person was in the employ of that employer on the date of their death.

No value is placed on a medical benefit as contemplated in paragraph 2(j) where such medical service is provided to comply with a law of South Africa, or is provided in general to the employees at their place of work for the better performance of their duties or where the medical treatment provided constitutes the provision of prescribed minimum benefits.

2.5 Special Trusts

The Income Tax Act provides for a unique type of trust which is created for the sole benefit of a person(s) with a "disability". These special trusts enjoy preferential tax treatment when compared to ordinary trusts as they are not taxed at the fixed rate of 40% (41% for the 2016 year of assessment) and the capital gains tax inclusion rate is not 66.6%. Instead, special trusts are taxed according to the same marginal tax tables as individuals and the individuals' capital gains tax inclusion rate of 33.3% applies. A special trust can also benefit from the capital gains tax annual exclusion and primary residence exclusions that are applicable to individuals and not to ordinary trusts. Owing to the importance of receiving this preferential tax treatment, it is important for the founders and trustees of a trust created for the benefit of a person with an incapacitating "disability" to ensure that they have considered all the necessary legislative requirements when creating and managing such trust.

It should be noted that a special trust is not entitled to any of the relief contained in either section 6A or section 6B; this relief in respect contributions to a medical scheme and qualifying medical expenses is only available to natural person taxpayers. Accordingly, during the lifetime of the donor(s), if the section 6A and section 6B tax relief is sought, it is very important for the founders and trustees of a special trust to ensure that they do not place funds in the special trust with the intention of using such funds for the purpose of paying medical scheme contributions or qualifying medical expenses. In order to benefit from the relief provided by section 6A and section 6B, the natural person taxpayer must incur and pay the contributions and qualifying medical expenses him- or herself. Where a special trust has been created with the intention of sponsors providing financial assistance in respect of the medical scheme contributions, medical expenses and other expenses incurred and paid in consequence of the beneficiary's "disability", the section 6A and section 6B will not be available. It is submitted that the legislature should consider expanding the provisions of section 6A and section 6B to allow for special trusts to receive the same tax relief that is afforded to natural persons by those sections.

In terms of section 5(2) of the Income Tax Act:

> Subject to the provisions of subsection (7) and the Fourth Schedule, the rates of tax chargeable in respect of taxable income shall be fixed annually by Parliament, but the rates fixed by Parliament in respect of any year of assessment or financial year shall be deemed to continue in force until the next such determination of rates and shall be applied for the purposes of calculating the tax payable in respect of any such taxable income received by or accrued to in favour of any *person* [own emphasis] during the next succeeding year of assessment or financial year, as the case may be, if in the opinion of the Commissioner the calculation and collection of the tax chargeable in respect of such taxable income cannot without risk of loss or revenue be postponed until after the rates for that year have been determined.

Paragraph (c) of the definition of "person" as contained in section 1 of the Income Tax Act, specifically includes "*any trust*" in that definition. Accordingly, a trust is subject to the same rates. Paragraph 10(a) of the Eighth Schedule determines that a special trust will enjoy the inclusion rate of 33.3%, compared to the inclusion rate of 66.6% that is applicable to a normal trust by virtue of paragraph 10(c) of that Schedule.

In the context of the present research, the applicable part of the definition of a "special trust" as contained in section 1 of the Income Tax Act, read as follows:

> a trust created
>
> (a) solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1) where such disability incapacitates such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs:
>
> Provided that –
>
> (aa) such trust shall be deemed not to be a special trust in respect of years of assessment ending on or after the date on which all such persons are deceased; and
>
> (bb) where such trust is created for the benefit of more than one person, all persons for whose benefit the trust is created must be relatives in relation to each other.

Paragraph (b) of the definition of a "special trust" makes a provision for a second type of special trust: a trust that has been established by or under the will of a deceased person for the

benefit of, amongst others, relatives of the deceased person when the youngest beneficiary is under the age of 21 years. This type of special trust will not be discussed as it is not relevant for the present research. Accordingly, all references to a "special trust" for the purposes of the discussion refer to the type of special trust as envisaged in paragraph (a) above.

Created for the sole benefit of one or more persons with an incapacitating "disability"

In order to qualify as a special trust, the trust needs to have been created solely for the benefit of one or more persons who are persons with a "disability" as defined in section 6B(1). Accordingly, a special trust can only have natural persons as beneficiaries. Paragraph (a) of the definition of a "special trust" as contained in section 1 of the Income Tax Act was amended by the Taxation Laws Amendment Act 31 of 2013 with effect from the commencement of the 2015 tax year to ensure that it refers to a "disability" as defined in section 6B(1) instead of the repealed section 18 definition. The word "*created*" implies that from the trust's original inception, the trust must have been set up for the sole benefit of one or more persons who is or are persons with a "disability" as defined and that an existing trust cannot simply be converted to a special trust by way of amending the trust deed. It is submitted that amending the trust deed of a trust that was previously created in a manner that does not satisfy the requirements of the definition of a "special trust" so as to ensure that such requirements are subsequently met would not meet the requirement of the definition that the trust is *created* solely for the benefit of qualifying persons. It is therefore important that a founder who is in a position to be able to create a special trust carefully considers the provisions of the trust deed at the time of inception as adverse tax consequences could arise if the founder transfers the assets from a normal trust to a special trust at a later stage.

A special trust can be either

- an *inter vivos* trust created during the lifetime of the trust's founder;
- a testamentary trust created by or under the will of a deceased person; or
- a trust created as a result of a court order in favour of a specified natural person.

The fact that a trust has been created for the sole benefit of a person with a "disability" as defined in section 6B(1) will not be sufficient to meet the requirements of the definition of a "special trust". A second test must be performed to ascertain whether the "disability"

incapacitates the person from earning sufficient income for their maintenance or from managing their own financial affairs.

It is not necessary that the "disability" incapacitates the person from earning sufficient income and that such "disability" also incapacities the person from managing their own financial affairs, as the definition uses the word "*or*". For example, a person with certain psychological disorders might be able to earn sufficient income for their maintenance; however, such disorder could incapacitate the person from managing his or her own financial affairs.

It is submitted that the word "*sufficient*" makes this test a subjective one as the definition states "*sufficient income for their maintenance*" (emphasis added). For example, a taxpayer with a "disability" as defined might be able to secure employment that generates income that could be sufficient for the maintenance of certain people, but that is not sufficient for the maintenance of that person based on the particular disabled person's needs.

A further aspect of subjectivity is whether the "disability" has actually incapacitated the person. For example, one person might be incapacitated by their "disability", however, a second person, with a similar "disability", could be earning a sufficient income to maintain a lifestyle that both persons are accustomed to and is managing their own financial affairs. This aspect of subjectivity would include factors such as attitude, perception, willpower, and support structures.

An area of the definition of a "special trust" that requires clarity is, in the case of a minor disabled person, the requirement that the "disability" incapacitates the person from maintaining him- or herself or from managing his or her own financial affairs. A strict interpretation of the definition would conclude that the person's "disability" must incapacitate the person from earning a sufficient income or prevent the person from managing his or her own financial affairs during that particular year of assessment. A child's age and their lack of education, skills and maturity could be what prevents a child from earning sufficient income or from managing his or her own financial affairs and not the "disability" as such. For example, a child with a severe mental impairment is unlikely to be able to earn an income or maintain their financial affairs at the age of four, but it is not the child's "disability" that has incapacitated the child from doing so. A child is capable of deriving income from sources other than employment, for example, rental income, interest or dividends. It is, unlikely, however, that a child has established such income sources

themselves. Although the child might be receiving the fruits of an asset which is in his or her name, it cannot be said that the earning of such income by the child means that the child is not incapacitated from maintaining him- or herself. A further concern is that it might only become apparent at an older age that a child's "disability" will in fact incapacitate that child from earning a sufficient income or maintaining his or her own financial affairs. For example, it could be an expectation that the child will be able to do those things after appropriate special needs schooling, therapies and other interventions, however, it could at a later stage become apparent after all such efforts that the child will not be able to earn a sufficient income for his or her maintenance or be able to manage his or her own financial affairs. The strict interpretation mentioned above would mean that the special trust could only be created when the child is at an age where it can be said for certain that it is the "disability" that is incapacitating the child from earning a sufficient income for his or her maintenance or managing his or her own financial affairs. It is submitted that this is not the intention of the legislature and a recommended amendment in this regard will be discussed in Chapter Four.

If a special trust is created for the benefit of a person who has an incapacitating "disability" and that person is, through appropriate rehabilitation or other interventions, no longer incapacitated by such "disability", a strict interpretation of the definition of a "special trust" would mean that that trust is deemed not to be a special trust in respect of years of assessment ending on or after the date on which such incapacitation is no longer present. Whilst it is unlikely that such circumstances will arise, as the definition of a "special trust" would no longer be met, such trust can no longer be taxed as a special trust.

To meet the requirements of a special trust, the trust deed must ensure that such trust has been created only for the benefit of one or more persons who is or who are persons with a "disability" as defined in section 6B(1). Accordingly, it is not possible for the special trust to have any beneficiaries other than the persons with a "disability" during the lifetime of such persons. It is important that the trust deed of a special trust does not include provisions which enable any person who is not a person with an incapacitating "disability" (including persons who have not yet been born) to obtain a vested right or discretionary right to any income (capital or revenue) of the trust as long as a beneficiary or the beneficiaries for whose sole benefit the trust was created is alive. As soon as a non-qualifying beneficiary obtains any right to the income of a special trust, such trust will no longer be afforded the status of a special trust and it will be taxed as a normal trust for that year of assessment. Irrespective of the date of death during the year of assessment of the last surviving beneficiary of a special

trust, such trust will be taxed as a normal trust from that year of assessment. The fact that the trust must be created for the benefit of one or more persons who is or who are persons with an incapacitating "disability" does not mean that the beneficiaries of the trust should have a vested right to that trust's income (capital or revenue) in order to qualify as a special trust. In fact, such vested right would mean that the provisions of the Income Tax Act relating to special trusts would not be of any application to that income and the beneficiary with the vested right would be taxed on such income in his or her own hands per the provisions of section 25B(1) of the Income Tax Act. The provisions relating to the taxation of a special trust are only applicable when the income is to be taxed in the trust; accordingly, such provisions would not be applicable when a beneficiary of a vesting trust has a vested right to the income (capital or revenue) derived by the trust.

More than one person with an incapacitating disability

If a special trust is created for the benefit of more than one person with an incapacitating "disability", all such persons must be relatives in relation to each other.

A "relative" is defined in section 1 of the Income Tax Act as

> in relation to any person, means the spouse of such person or anybody related to him or his spouse within the third degree of consanguinity, or any spouse of anybody so related, and for the purpose of determining the relationship between any child referred to in the definition of "child" in this section and any other person, such child shall be deemed to be related to its adoptive parent within the first degree of consanguinity.

It is important to note that each person must be a relative in relation to each other; it is not sufficient that the person merely is a relative of a relative. Whilst it is a requirement that each beneficiary is a relative in relation to each other, it is not necessary for any of the beneficiaries to be a relative of the founder of the special trust. For example, a person may create a special trust for the sole benefit of his or her friend or a distant relative who does not meet the section 1 definition of a "relative".

In relation to any person, a relative as defined in section 1, means

(a) a person's spouse;

(b) any person related to the person within the third degree of consanguinity;

(c) any person related to the person's spouse within the third degree of consanguinity; or

(d) the spouse of a person mentioned in (b) or (c).

The previous discussion in respect of the definition of "spouse" is of relevance in determining whether a person is considered a person's spouse.

The table below demonstrates the degree of consanguinity in respect of the relation to a person. It should be noted that a person's cousin is not within the third degree of consanguinity and thus a special trust cannot be created solely for the benefit of one or more cousins with an incapacitating "disability".

Table 4 Degrees of consanguinity

Degree of consanguinity	Relation to person
First	Children (including adopted children), parents
Second	Grandchildren, brothers, sisters, grandparents
Third	Great-grandchildren, nephews, nieces, uncles, aunts, great-grandparents

It is only recently that a special trust could be created for the benefit of more than one person. The definition of a "special trust" as contained in section 1 of the Income Tax Act was amended by The Taxation Laws Amendment Act 22 of 2012 to allow such trust to be created for the benefit of "*one or more persons*", provided such persons are all relatives in relation to each other and that they each have an incapacitating "disability". The amendment which allows for a special trust to be created for the benefit of more than one person became effective from the commencement of the 2013 year of assessment.

The provisions of sections 7 and 25B of the Income Tax Act that are applicable to a normal trust are also applicable to a special trust. In terms of section 25B(1)

> any amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.

Accordingly, if no beneficiary has a vested right to the income of a trust under the trust deed, the trust's income is treated as having accrued to the trust, unless a distribution of that income is made to a beneficiary in the relevant year of assessment. In the context of trusts, section 7 will deem certain income to accrue to the donor, the trust or a beneficiary. The relevant provisions of the Income Tax Act that provide tax benefits to a special trust will only be applicable when income is to be taxed in the trust. A discussion of the provisions of section 7 and section 25B is beyond the scope of the present research.

Rates of tax and income tax exemptions applicable to a special trust

Paragraph 1 of Appendix I of the Rates and Monetary Amounts and Amendment of Revenue Laws, Act No. 42 of 2014, sets out the table which determines the rate of tax applicable to the taxable income of a natural person, deceased estate, insolvent estate and a special trust in respect of any year of assessment commencing on 1 March 2014 or ending on 28 February 2015. Accordingly, the taxable income of a special trust is taxed with reference to the same tax tables as in the case of a natural person taxpayer and not the single rate of 41% that applies to a normal trust with effect from 1 March 2015.

Whilst the taxable income of a special trust is taxed at the same rates of normal tax applicable to a natural person, it does not qualify for the section 6 primary, secondary and tertiary rebates or the interest exemption under section 10(1)(i) to which natural person taxpayers are entitled. Unlike the section 10(1)(i) interest exemption which is only applicable to natural person taxpayers, a special trust is entitled to the section 10(1)(k) local dividend exemption that applies to all taxpayers. A special trust is entitled to a section 10B(3) exemption of foreign dividends in the same ratio as that applicable to natural persons.

Section 10A of the Income Tax Act provides for a partial exemption of a purchased annuity. In terms of section 10A(2),

> there shall be exempt from normal tax so much of any annuity amount payable to a purchaser or his spouse or surviving spouse (as contemplated in paragraph (a) of the definition of "annuity contract" in subsection (1)), or to the deceased or insolvent estate of such spouse or surviving spouse as is determined in accordance with subsection (3) to represent the capital element of such amount.

The term "purchaser" is defined in section 10A(1) as

> in relation to an annuity contract means-

(a) any natural person and includes such person's deceased or insolvent estate; or

(b) a curator bonis of, or a trust created solely for the benefit of, any natural person where the High Court has declared such person to be of unsound mind and incapable of managing his own affairs and such Court has ordered the appointment of such curator or creation of such trust, as the case may be.

It is likely that a special trust will qualify as a trust created under the circumstances contemplated in paragraph (b) of the definition of a "purchaser" as defined in section 10A(1), especially given the requirement of that definition that the trust must be created solely for the benefit of person who is incapable of managing his or her own affairs. Where a special trust is one which meets the definition of a "purchaser" in relation to an annuity contract, the determined capital element of a purchased annuity should be exempt from normal tax if such annuity is payable to the special trust.

Capital gains tax provisions relevant to special trusts

The capital gains tax provisions of the Eighth Schedule to the Income Tax Act that apply to a normal trust generally also apply to a capital gain or loss that is taxable in a special trust. The attribution rules as contained in paragraphs 68 to 72 and 80 of the Eighth Schedule determine whether a capital gain should be accounted for by the trust or attributed to another person. The Eighth Schedule also contains certain provisions that are only applicable to a special trust. In terms of paragraph 10 of the Eighth Schedule,

a person's taxable capital gain for the year of assessment is –

(a) in the case of a natural person or a special trust as defined in section 1 of the Income Tax Act, 33,3 per cent of that person's net capital gain for that year of assessment.

The inclusion rate of 33.3% of an aggregate capital gain is a further benefit of a special trust when compared to the taxation of a normal trust; the aggregate capital gain of a normal trust is included in the taxable income of such trusts at 66.6%. It should be noted that paragraph 10 of the Eighth Schedule makes specific reference to "*special trust as defined in section 1 of the Income Tax Act*" instead of merely stating "*special trust*". This is because a special trust as defined in section 1 of the Income Tax Act includes both types of special trusts, whereas, the definition of "special trust" for the purposes of the Eighth Schedule as contained in section 1 of that Schedule only includes the type of special trust that is applicable in the context of this

research: a special trust created solely for the benefit of a person with an incapacitating "disability".

In terms of paragraph 5 of the Eighth Schedule,

> (1) Subject to subparagraph (2), the annual exclusion of a natural person and a special trust in respect of a year of assessment is R30 000.

Unlike other trusts, a special trust created solely for the benefit of a person with an incapacitating "disability" is entitled to the same R30 000 capital gains tax annual exclusion as that which applies to a natural person taxpayer.

Compared to other trusts, a further benefit of a special trust that is created solely for the benefit of a person with an incapacitating "disability" is that such special trusts are entitled to same primary residence exclusion as is applicable to natural person taxpayers.

In terms of paragraph 45(1) of the Eighth Schedule,

> subject to subparagraphs (2), (3) and (4), a natural person or a special trust must, when determining an aggregate capital gain or aggregate capital loss, disregard-
>
> (a) so much of a capital gain or capital loss determined in respect of the disposal of the primary residence of that person or that special trust as does not exceed R2 million; or
>
> (b) a capital gain determined in respect of the disposal of the primary residence of that person or that special trust if the proceeds from the disposal of that primary residence do not exceed R2 million.

Accordingly, a special trust must disregard any capital gain or loss on the disposal of a primary residence to the extent that the capital gain or loss does not exceed R2 million. Furthermore, if the proceeds on the disposal of the primary residence do not exceed R2 million, the capital gain or loss on such disposal by a special trust must be disregarded.

In the context of a special trust, the term "primary residence" is defined in paragraph 44 of the Eighth Schedule as a residence

> (a) in which a special trust holds an interest; and
>
> (b) which a beneficiary of that special trust or a spouse of that beneficiary

(i) ordinarily resides or resided in as his or her main residence; and

(ii) uses or used mainly for domestic purposes.

Accordingly, in order for a special trust to qualify for the primary residence exclusion, the trust must hold an interest in that residence and a beneficiary (or his or her spouse) of that trust must reside (or have resided) in that residence as his or her main residence and such person must use (or have used) that residence mainly for domestic purposes. In determining whether a special trust qualifies for the primary residence exclusion it is necessary to establish whether that trust holds an interest in the applicable residence.

"An interest" is defined in paragraph 44 of the Eighth Schedule as

(a) any real or statutory right; or

(b) a share owned directly in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980) or a share or interest in a similar entity which is not a resident; or

(c) a right of use or occupation,

but excluding-

(i) a right under a mortgage bond; or

(ii) a right or interest of whatever nature in a trust or an asset of a trust, other than a right of a lessee who is not a connected person in relation to that trust;

Where a special trust has ownership of a residence, it should be considered to hold an interest in that residence. The definition of "an interest" specifically excludes any right or interest of whatever nature in a trust or an asset of a trust, other than a right of a lessee who is not a connected person in relation to the trust. Accordingly, a beneficiary who holds an interest in a residence owned by the special trust cannot be said to have "an interest" as defined in that residence. A beneficiary holding such interest would not be entitled to claim the primary residence exclusion in relation to that property as it cannot be said that such beneficiary has an interest in the residence owned by the trust. Whilst the beneficiary would not be entitled to the primary residence exclusion, the property owned by the special trust will still be considered as a "primary residence" of that trust and should qualify for the primary residence exclusion provided a beneficiary or a spouse of a beneficiary ordinarily resides in that property as his or her main residence and uses it mainly for domestic purposes. In order for

the primary residence exclusion to apply in a special trust, it is of utmost importance that no beneficiary has a vested interest in that residence.

In terms of paragraph 82 of the Eighth Schedule,

> where a beneficiary of a special trust dies, that trust must continue to be treated as a special trust for the purposes of this Schedule until the earlier of the disposal of all assets held by that trust or two years after the date of death of that beneficiary.

Notwithstanding the death of the beneficiary or beneficiaries for whose sole benefit a special trust was created, the trust will remain a special trust for capital gains tax purposes until the earlier of the disposal of all the assets held by the trust or two years after the date of death of the last living beneficiary. As previously mentioned, the rates of tax that are usually applicable to a special trust only apply for the years of assessment during which a beneficiary of the trust is alive on the last day of a particular year of assessment. Accordingly, whilst the trust will benefit from the more favourable capital gains tax provisions that apply to a special trust for the extended period in terms of paragraph 82 of the Eighth Schedule to the Income Tax Act, the rate at which the taxable income of the trust will be taxed will be the single rate of 40% (41% from 1 March 2015) that applies to other trusts.

Donations tax

There is no special provision that exempts a donor from donations tax if such donation is made specifically to a special trust. Accordingly, donations tax could be payable by a donor in respect of donations of property to a special trust. The standard donations tax exemptions contained in section 56 of the Income Tax Act will be applicable. For example, in terms of section 56(2)(b), the sum of donations by a natural person during a year of assessment is exempt from donations tax to the extent that it does not exceed R100 000. Section 56(2)(c) of the Income Tax Act provides that no donations tax shall be payable in respect of "*so much of any bona fide contribution made by the donor towards the maintenance of any person as the Commissioner considers to be reasonable*." If a special trust has been created for the sole benefit of a person who is a person with a "disability" as defined and such "disability" incapacitates the person from earning sufficient income for his or her maintenance, it is expected that such person will be reliant on other people for their maintenance. Accordingly, if a donation is made to a special trust which has been created for the sole benefit of a person who has a "disability" that incapacitates them from earning sufficient income for their

maintenance, such donation should be exempt from donations tax, provided that the Commissioner would consider such donation to be reasonable. It is submitted that, in the case of a person who has an incapacitating "disability" that prevents the person from being able to maintain him- or herself, the donor should be able to satisfy the Commissioner that the donation is reasonable and made towards the maintenance of any person. It should be noted that section 56(2)(c) makes no reference to the relationship between the donor and the donee; accordingly, it is not necessary for the donor to be a relative of the beneficiary. Also, the donation only needs to be made "*towards the maintenance of any person*" and not necessarily to the person requiring the maintenance; this implies that the donation can be made to the special trust and does not need to be made directly to the beneficiary.

2.6 Conclusion

This chapter has provided a detailed analysis of sections 6A and 6B of the Income Tax Act as well as the provisions of the Income Tax Act that pertain specifically to special trusts. The analysis of these provisions has addressed the goal of analysing the South African tax legislation that relates to medical expenses with a particular emphasis on the legislation that is specifically applicable to a person who has a physical impairment or a "disability".

This chapter included a brief overview of the transition from the section 18 tax deduction to the section 6A and 6B tax credits as well as a comparison of the relief afforded by the credits with that which was provided by section 18. The section 6A medical scheme fees tax credit was critically analysed and particular attention was given to the medical scheme premiums paid by a person with a physical impairment or "disability". This analysis considered the requirements for taking the medical scheme fees tax credit into account and whether the person could receive relief in respect of medical fees he or she paid for persons other than themselves. The discussion included an in-depth analysis of the definitions of a person's "dependant", "spouse" or "child". A further aspect of the section 6A medical scheme fees tax credit that was considered is the deeming provisions in respect of medical scheme premiums that were paid by the taxpayer's employer or estate.

This chapter focused mainly on the section 6B additional medical expenses tax credit and how it provides relief in respect of excess medical scheme contributions, out-of-pocket medical expenses and expenses incurred in consequence of a person's physical impairment or "disability"; particular attention was given to the principles of "*necessarily incurred*" and "*in*

consequence of" in the context of an expense having been "*necessarily incurred in consequence of any physical impairment or disability*". A detailed analysis was provided in respect of each component of the definition of "qualifying medical expenses". The chapter also discussed the manner which the tax credit is calculated. Finally, Chapter Two also analysed the specific provisions of the Income Tax Act that are applicable to a special trust created for the benefit of a person with a physical impairment or "disability".

Having determined that the relief available to qualifying persons is limited by the diagnosis criteria and qualifying expenditure as prescribed by the Commissioner, it is important to evaluate the extent to which medical schemes provide coverage for non-discretionary expenditure items incurred in consequence of a person's physical impairment or "disability". If a person with a "disability" incurs an expense in consequence of his or her "disability" and such expense is not prescribed by the Commissioner, the person will not be able to seek tax relief in respect of that expense and could be faced with a financial burden if his or her medical scheme does not cover all or part of that expense. The person would be in a position where he or she is required to incur a non-discretionary expense in consequence of his or her "disability" without receiving either Income Tax relief or assistance from his or her medical scheme. If the person's medical scheme provides partial or full coverage of the expenditure item, the potential financial burden associated with that particular expense can be eased. Chapter Three will compare the expenditure items that are prescribed by the Commissioner with that which are generally covered by medical schemes to evaluate whether there is potential for situations where a person with a "disability" is faced with non-discretionary costs in consequence of his or her "disability" and there is neither income tax relief nor coverage by his or her medical scheme.

Chapter Three: Physical impairment or disability in the context of medical schemes

3.1 Introduction

A taxpayer who has a physical impairment or a disability or who has a dependant with such physical impairment or disability is often faced with burdensome medical and other related expenses. These expenses are generally non-discretionary and thus such taxpayers can be put under immense financial pressure to cover expenses that other taxpayers do not have to incur. If the medical treatment is not obtained and therefore the expenses are not incurred by the taxpayer the person with the physical impairment or disability could either die, suffer unnecessarily or lead a life with limitations placed on his or her basic functioning such as walking, communicating, thinking, learning, seeing, hearing and other such aspects of daily living. The goal of this chapter to evaluate the extent to which medical schemes provide coverage for non-discretionary expenditure items incurred in consequence of a person's disability. It is important to compare the type of disability-related expenditure items covered by medical schemes to the qualifying expenditure in terms of the Income Tax that the Commissioner has set out in the *List of Qualifying Physical Impairment or Disability Expenditure* to determine whether there are potential gaps in relief. If the particular type of expense is not included in the list and also not covered by the medical scheme, the taxpayer paying the amount could suffer serious financial difficulties, without any relief. Furthermore medical inflation may exceed the inflation-related increases in the Income Tax relief measures provided for in section 6B, thus reducing the potential benefit of the relief. This aspect is briefly discussed in this chapter.

3.2 Prescribed minimum benefits

In South Africa, there are various sources of relief for a person faced with the non-discretionary costs associated with a physical impairment or disability, including:

- state grants, and free or low-cost medical treatment at government hospitals, clinics, and related institutions;
- relief provided by non-government organisations, foundations, charities, public benefit organisations, and related organisations;

- income tax relief; and
- coverage by medical schemes.

The first two types of relief mentioned above are not within the scope of this research. The income tax relief available to qualifying taxpayers was discussed in Chapter Two of this thesis. There were two striking elements of the Chapter Two discussion on the available income tax relief; the first is that the Commissioner for SARS has been tasked with prescribing the list of qualifying physical impairment and disability-related expenditure and the second is that the Commissioner has also been granted the authority to prescribe the diagnosis criteria for a "disability". With such authority bestowed upon the Commissioner and the possible limitations this could place on the applicable income tax relief, it is important to consider the extent of the relief medical schemes are required to provide by law; the prescribed minimum benefits.

Section 7 of the Regulations in terms of the Medical Schemes Act defines "prescribed minimum benefits" as

> the benefits contemplated in section 29(1)(o) of the Act, and consist of the provision of the diagnosis, treatment and care costs of –
>
> (a) the Diagnosis and Treatment Pairs listed in Annexure A, subject to any limitations specified in Annexure A; and
>
> (b) any emergency medical condition.

An "emergency medical condition" is defined in section 7 of the Regulations in terms of the Medical Schemes Act as

> the sudden and, at the time, unexpected onset of a health condition that requires immediate medical or surgical treatment, where failure to provide medical or surgical treatment would result in serious impairment to bodily functions or serious dysfunction of a bodily organ or part, or would place the person's life in serious jeopardy.

In terms of section 29(1) of the Medical Schemes Act,

> the Registrar shall not register a medical scheme under section 24, and no medical scheme shall carry on any business, unless provision is made in its rules for:
>
> (o) The scope and level of minimum benefits that are to be available to beneficiaries as may be prescribed.

(p) No limitation shall apply to the reimbursement of any relevant health service obtained by a member from a public hospital where this service complies with the general scope and level as contemplated in paragraph (o) and may not be different from the entitlement in terms of a service available to a public hospital patient.

Accordingly, every plan or policy offered by a medical scheme must, as minimum, cover a beneficiary for the prescribed minimum benefits. The medical scheme must cover the costs related to the diagnosis, treatment and care of any emergency medical condition, a limited set of 270 medical conditions (defined in the Diagnosis and Treatment Pairs), and 25 chronic conditions (defined in the Chronic Disease List) (Council for Medical Schemes: 2015).

The 270 medical conditions that qualify for prescribed minimum benefit coverage are divided into 15 broad categories:

- brain and nervous system;
- eye;
- ear, nose, mouth and throat;
- respiratory system;
- heart and vasculature (blood vessels);
- gastro-intestinal system;
- liver, pancreas and spleen;
- musculoskeletal system (muscles and bones): Trauma (not otherwise specified);
- skin and breast;
- endocrine, metabolic and nutritional;
- urinary and male genital system;
- female reproductive system;
- pregnancy and childbirth;
- haematological, infectious and miscellaneous systemic conditions; and
- mental illness.

The Chronic Disease List ("CDL") specifies the medication and treatment for the 25 chronic conditions that qualify for prescribed minimum benefit coverage:

- Addison's disease;
- asthma;

- Bipolar Mood Disorder;
- bronchiectasis;
- cardiac failure;
- cardiomyopathy;
- chronic obstructive pulmonary disorder;
- chronic renal disease;
- coronary artery disease;
- Crohn's disease;
- diabetes insipidus;
- diabetes mellitus types 1 & 2;
- dysrhythmias;
- epilepsy;
- glaucoma;
- haemophilia;
- hyperlipidaemia;
- hypertension;
- hypothyroidism;
- multiple sclerosis;
- Parkinson's disease;
- rheumatoid arthritis;
- schizophrenia;
- systemic lupus erythematosus; and
- ulcerative colitis.

Each of the CDL conditions has had a treatment algorithm published in the Government Gazette, which provides a benchmark for the minimum standard of treatment that a medical scheme has to provide in respect of the applicable CDL condition. A detailed analysis of the minimum treatment standards for each condition is beyond the scope of this research; however, a brief overview of the minimum standards as they pertain to Bipolar Mood Disorder is given below.

The treatment algorithm for Bipolar Mood Disorder was published in the Government Gazette on 21 December 2009 and sets out the minimum standard of treatment that must be provided (Government Gazette: 2009). This treatment algorithm starts with a diagnosis and

then states which prescription medication should be administered, based on whether the person is having a manic episode or a depressive episode. It also provides guidelines for what treatment actions should be taken, based on whether the person has reached a state of remission or not. Bipolar Depression is also included as a medical condition under the mental illness section in Annexure A of the Medical Schemes Act. According to the relevant Diagnosis and Treatment pair, a person must, as a minimum, receive up to 3 weeks per year of hospital-based management (including inpatient electro-convulsive therapy and inpatient psychotherapy) or outpatient psychotherapy of up to 15 contacts. Thus, in the case of Bipolar Mood Disorder, the minimum treatment in terms of a diagnosis, medication, in-hospital care, and outpatient sessions are set out in the Diagnosis and Treatment pair and in the treatment algorithm as published in the Government Gazette.

If a person has been diagnosed with Bipolar Mood Disorder in terms of the diagnostic criteria as contained in the Diagnostic and Statistical Manual IV-TR (DSM-IV-TR) and his or her Global Assessment Functioning Score (GAF-Score) is lower than 60, the person should be considered to have a "disability" as defined in section 6B. This conclusion is arrived at, because, for Income Tax purposes, a person is considered to meet the criteria for the "mental" section of the ITR-DD form if that person has been diagnosed in accordance with the criteria set out in the DSM-IV-TR and if he or she has been attributed a GAF-Score that is lower than 60 (SARS: 2010b). Accordingly, where a taxpayer or his or her spouse or child has been diagnosed with such "disability", the taxpayer will receive the following relief:

- medical scheme coverage of expenses in terms of the prescribed minimum benefits;
- medical scheme coverage of expenses in terms of additional benefits of the scheme;
- income tax relief in respect of medical scheme contributions (subject to the provisions of sections 6A and 6B);
- income tax relief in respect of non-recoverable out-of-pocket medical expenditure (subject to the provisions of section 6B); and
- income tax relief in respect of expenditure, other than medical expenditure, necessarily incurred in consequence of Bipolar Mood Disorder.

A person with Bipolar Mood Disorder is unlikely to incur significant non-medical expenditure in consequence of the "disability" as contemplated in paragraph (c) of the definition of 'qualifying medical expenses' as contained in section 6B of the Income Tax Act; the majority of such expenditure would consist of travel expenditure incurred to acquire

prescription medication or travelling for psychiatric hospital visits or psychotherapy. Accordingly, the authority bestowed upon the Commissioner to prescribe qualifying expenditure incurred in consequence of physical impairment or "disability" is not of major relevance in the case of Bipolar Mood Disorder because the expenditure incurred in relation to that "disability" is predominantly of a medical nature; such medical expenditure is either covered by the medical scheme in terms of the prescribed minimum benefits or additional benefits of the scheme or it meets the requirements of paragraph (a) of the definition of "qualifying medical expenses" and can give rise to income tax relief.

3.3 Physical impairment or disability expenditure covered by medical schemes

It is important to distinguish between a medical condition and a "disability" for Income Tax purposes. There is no definitive list of qualifying disabilities that will be considered a "disability" for Income Tax purposes. Instead, qualifying diagnosis criteria are set out in the ITR-DD with particular reference to the limitations placed on a person's ability to function or perform daily living activities. For example, diabetes itself is not considered to be a "disability"; however, if the diabetes results in a person having limited vision or restrictions placed on their physical abilities, it is possible that such limitations could give rise to a "disability" for Income Tax purposes. This approach is very different to that taken in respect of the CDL which is a specific list of medical conditions that will be covered by the prescribed minimum benefits. The CDL has been created specifically in the context of medical schemes, which, as is discussed below, generally only cover medical related expenditure. For almost all of the diseases listed in the CDL, the person suffering from any such disease is unlikely to incur significant non-medical expenditure in consequence of that disease. Accordingly, whilst the matter might not be of significant relevance in the case of the diseases listed on the CDL, the available relief in respect of non-medical expenditure incurred in consequence of a "disability" is certainly important for the purpose of this research. If a person incurs non-medical expenditure in consequence of a physical impairment or "disability", it is likely that the only relief available to them will be that contained in section 6B of the Income Tax Act as the coverage of non-medical expenditure is in most instances expected to be beyond the business of a medical scheme.

The "business of a medical scheme" is defined in section 1 of the Medical Schemes Act as

> the business of undertaking, in return for a premium or contribution, the liability associated with one or more of the following activities:
>
> a) providing for the obtaining of any relevant health service;
>
> b) granting assistance in defraying expenditure incurred in connection with the rendering of any relevant health service; or
>
> c) rendering a relevant health service, either by the medical scheme itself, or by any supplier of group of suppliers of a relevant health service or by any person, in association with or terms of an agreement with a medical scheme.

Based on the above definition, the business of a medical scheme is the undertaking of the liability associated with health services. Accordingly, when evaluating the extent to which a medical scheme provides financial relief where a taxpayer or his or her spouse, child or dependant is a person with a physical impairment or "disability", it is not expected that such relief should be provided beyond the scope of the medical expenditure contemplated in paragraph (a) of the definition of 'qualifying medical expenses' as contained in the Income Tax Act. The extent to which a medical scheme provides relief in respect of medical expenditure beyond the prescribed minimum benefits is based on the benefits offered on the various plans by each medical scheme. From the discussion in Chapter Two, and based on the comparison provided of the Discovery Medical Scheme plans in that chapter, generally, the higher the premium paid by the member, the greater the coverage offered by the medical scheme. Also, a medical scheme will often place annual limits on the benefits offered, depending on the type of benefit and the plan elected by the member. Some medical schemes will offer coverage in respect of non-medical related expenditure such as mobility aids, hearing aids, optical expenditure such as frames or lenses, cochlear implants, breathing devices, and prosthetic limbs. It can be said that such expenditure pertains to a health service offering and is thus within the "business of a medical scheme". Once again, the extent of such coverage is usually dependant on the type of benefit and the member's choice of plan. The table below compares the extent of the coverage offered by some of Discovery Medical Scheme's various plans in respect of expenditure items that are generally associated with disabilities. It is assumed that there is a single member on the scheme with no dependants and the information is based on the offerings for the 2015 calendar year.

Table 5 Discovery Medical Scheme coverage of disability-related expenses by plan

	Executive	Classic Comprehensive	Essential Comprehensive	Classic Priority	Essential Priority
Occupational therapy, physiotherapy, speech and language therapists, audiologists	R16 550	R13 100	R7 900	R7 900	R5 250
Hearing Aids	R20 800	R20 800	R16 600	R16 600	R11 800
External medical items	R56 000	R56 000	R37 500	R37 500	R25 200
Optical (lenses, frames, contact lenses)	R5 700	R3 850	R3 850	R3 550	R3 550

Source: Discovery Health (2015: online)

"External medical items" refers to items such as a standard wheelchair, lightweight wheelchair, motorised wheelchair, scooters, walkers, breathing apparatus, and insulin pumps. All of Discovery Medical Scheme's plans, except for Discovery KeyCare include coverage for up to R187 000 per year per person per benefit in respect of cochlear implants, auditory brain implants and processors (Discovery Health, 2015: online)). The same set of plans also include unlimited covered for a hip, knee and shoulder joint prosthesis if acquired from a Discovery preferred supplier; if the prosthesis is acquired from an alternative supplier, there is a limit of R36 400 per year per prosthesis. All of the Discovery Medical scheme plans include coverage for 21 days per person per year in a mental health institution.

3.3 Additional relief in terms of the Income Tax Act

Whilst a person's medical scheme might offer some coverage in respect of non-medical related expenditure, to a large extent such expenses are usually not within the remit of the "business of a medical scheme" and often the only available relief is that which is afforded through the provisions of section 6B of the Income Tax Act. The following are examples of such non-medical related expenditure that a person might incur in consequence of physical

impairment or “disability” in respect of which income tax relief is sometimes the only available form of financial relief:

- personal attendant care expenses;
- travel and other related expenses;
- insurance, maintenance, repairs and supplies in relation to aids, devices, alterations to assets or artificial limbs;
- aids and devices such as computer equipment required to convert printed material to speech or navigation aids;
- services such as sign-language interpretation services or special needs education schooling;
- diapers;
- food and veterinarian care for a service animal; and
- alterations to an asset, such as lowering counters or installing support railings in a bathroom.

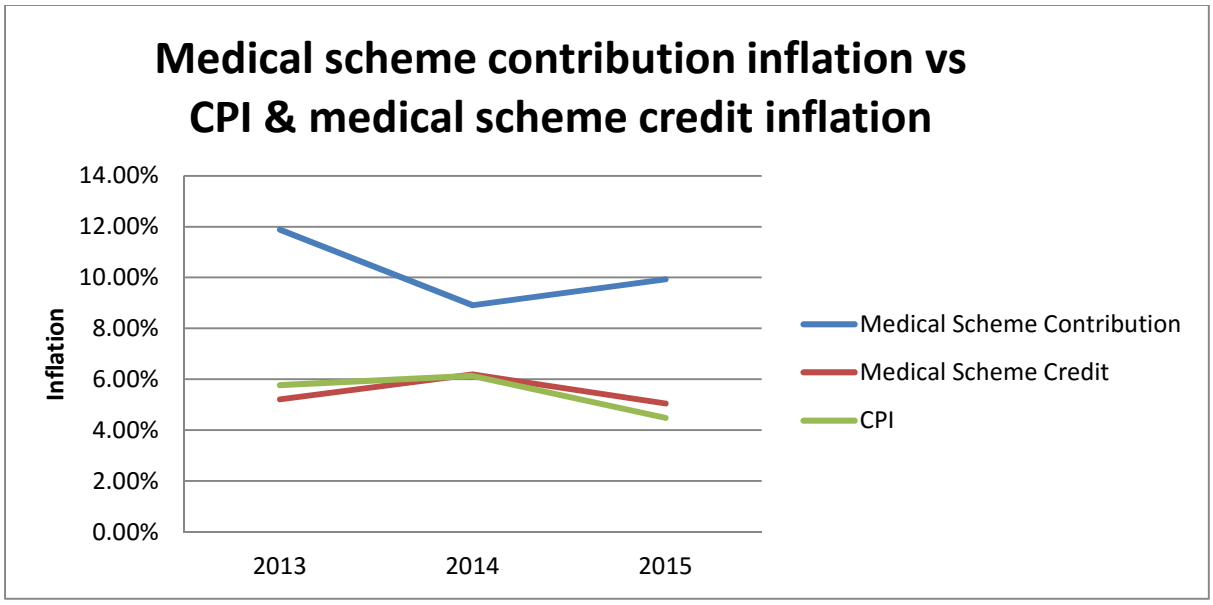
Owing to the fact that the income tax relief as contained in section 6B is often the only form of financial relief available to a person in respect of the expenditure necessarily incurred in consequence of his or her physical impairment or “disability”, it is submitted that the authority bestowed upon the Commissioner to prescribe which items of expenditure will qualify for such relief is of significance. Section 4(1)(a)(i) tasks the Commissioner with the responsibility of enforcing the provisions of the Income Tax Act, whilst the definition of “qualifying medical expenses” as contained in section 6B also gives the Commissioner the authority to dictate the rules that SARS will be enforcing. It is submitted that for an expense to meet the requirements of paragraph (c) of the definition of “qualifying medical expenses”, it should be sufficient for such expense to have been necessarily incurred and paid by the taxpayer during the year of assessment in consequence of any physical impairment or “disability” suffered by the taxpayer or any dependant of the taxpayer. It is further submitted that there should not be a further requirement that such expense must be one which is prescribed by the Commissioner.

3.4 The effect of inflation

A further matter of concern is the annual increase in the section 6A medical scheme tax credit granted to a taxpayer in respect of contributions made to a medical scheme.

Figure 3 below compares the rate at which medical scheme contributions have increased year-on-year over a period of three years to the rate at which the section 6A medical scheme tax credit has increased over the same period. The periods shown are calendar years and not tax years. The Consumer Price Index (CPI) for the relevant periods has also been added (Global-rates.com, 2015: online). It should be noted that the CPI for the 2015 calendar year is taken from April 2015 and is thus not in respect of the full calendar year. The medical scheme contribution data refers to the premiums payable for a single member on the Discovery Medical Scheme Coastal Core plan. It should be noted that the Discovery Medical Scheme Coastal Core plan differs from the Classic Core plan offered by the same medical scheme that was discussed in Chapter 2. Over the period 2012 to 2015, this particular plan has had an average annual premium increase of 9.9%. For 2015, the average increases for the larger medical schemes are 7.2% (Bonitas), 7.9% (Momentum Health) 8.6% (Bestmed), 9.5% (Medshield), 9.9% (Discovery), and Medihelp (12.8%) (Watson, 2015, in Moneyweb: Online). Accordingly, the average 2015 premium increase across these six schemes was 9.3%. It is submitted that the data used is reflective of the average medical scheme contributions over the given period. The medical scheme tax credit data is the section 6A tax credit for a single member that is applicable for the majority of that calendar year; for example, the medical scheme tax credit for the 2014 tax year is applicable to the majority of the 2013 calendar year.

Figure 3 Medical scheme contribution inflation vs Consumer Price Index (CPI) and medical scheme fees tax credit inflation



It is clear from the graph that there is a correlation between the medical scheme tax credit and CPI. This indicates that the CPI is used as a reference when the section 6A medical scheme tax credit is determined. It is submitted that a better reference would be the rate at which medical scheme contributions are increasing, as the medical scheme tax credit is intended to provide relief in respect of the premiums paid to a medical scheme. It is evident that there is a significant gap between the annual increase in medical scheme contributions and the annual increase in the section 6A medical scheme tax credit. In real terms, year-on-year, taxpayers are receiving less relief in respect of the premiums paid to his or her medical scheme. However, as excess contributions qualify to a limited extent in terms of section 6B, some relief is available. A recommended amendment to section 6A will be discussed in Chapter Four.

3.5 Conclusion

The primary goal of this chapter was to evaluate the extent to which medical schemes provide coverage in respect of the expenditure incurred by persons in consequence of their physical impairment or disability. This goal was achieved by determining what type of expenditure a medical scheme is required to cover in terms of the law; these expenses are known as the Prescribed Minimum Benefits. This chapter also included an analysis of the coverage offered by Discovery Medical Scheme in respect of expenditure items that generally associated with disabilities. It was found that the majority of the expenses that are covered by a medical

scheme are medical in nature and that medical schemes are unlikely to cover many of the non-medical expenses considered in paragraph (c) of the definition of "qualifying medical expenses" as contained in section 6B of the Income Tax Act. If a person with a disability incurs expenditure in consequence of his or her disability a medical scheme will only generally provide coverage in respect of medical-related expenditure. Expenditure items such as special needs schooling, personal attendant care services, travel and other related expenses, incontinence products, service animals, and non-medical services such as sign-language interpretation or reading are examples of expense items that a person with a disability might incur that a medical scheme are unlikely to cover. These findings emphasise the importance of the tax relief that is available in respect of the non-medical expenditure incurred in consequence of a person's physical impairment or "disability", as the taxpayer is unlikely to get relief from his or her medical aid for these expenses. A further finding of this chapter is that the medical scheme tax credit as contemplated in section 6A of the Income Tax Act is not increased on an annual basis at a rate which is in line with the rate at which medical schemes increase his or her premiums.

Chapter Four: Conclusion

4.1 Summary of findings

This research involved a detailed critical analysis of the tax concessions available in respect of medical expenses, with a particular emphasis on sections 6A and 6B of the Income Tax Act as well as the provisions of the Income Tax Act that pertain to special trusts. The analysis of these provisions addressed the goals of analysing the South African tax legislation that pertains to medical expenses, with a particular emphasis on the legislation that is specifically applicable to a person who has a physical impairment or a "disability", analysing the definitions of and criteria for the recognition of a "disability" for tax purposes, analysing the specific expenditure items that qualify for the additional rebate in consequence of a person's physical impairment or "disability" and the goal of analysing the specific provisions of the Income Tax Act that are applicable to a special trust created for the benefit of a person with a physical impairment or "disability". The key finding of this analysis is that the relief that is available to qualifying persons is limited by the diagnosis criteria and qualifying expenditure as prescribed by the Commissioner.

The detailed analysis mentioned above resulted in identifying areas of the applicable legislation which could be amended. Accordingly, this research also includes findings in the form of recommended amendments to the legislation that is specifically applicable to persons with a physical impairment or "disability". These recommended amendments are addressed below in more detail. These findings addressed the goal of recommending possible amendments to the current provisions of the legislation that are specifically applicable to persons with a physical impairment or "disability"

A further finding of this research is that medical schemes tend to provide coverage only in respect of medical expenditure incurred in consequence of a person's physical impairment or "disability" and that there is limited or no coverage by medical schemes in respect of non-medical expenditure associated with such physical impairment or "disability". This finding highlights the importance of the tax relief that is available to taxpayers who incur non-medical expenditure in consequence of their physical impairment or "disability". These findings arose in pursuit of the goal of evaluating the extent to which medical schemes

provide coverage in respect of medical expenditure and whether such coverage differs from the type of expenditure contemplated in the applicable tax relief.

4.2 Recommended amendments to the current legislation

Words in bold type and enclosed in square brackets indicate a proposed deletion from the legislation. Underlined words indicate a proposed insertion into the legislation.

4.2.1 Definition of "disability" as contained in section 6B

"Disability"

means a moderate to severe limitation of a person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation—

a) has lasted or has a prognosis of lasting more than a year; and

b) is diagnosed by a duly registered medical practitioner in accordance with criteria [**prescribed by the Commissioner**] as set out in paragraph 1 of the Twelfth Schedule;

Explanation of the recommendation:

The Commissioner is charged with enforcing the provisions of the Income Tax Act. It is submitted that by allowing the Commissioner to prescribe the diagnosis criteria for a "disability", the Commissioner is granted authority to dictate exactly which taxpayers will qualify for the applicable tax relief. To avoid a situation where the Commissioner is given the authority to essentially create the laws that SARS will enforce, it is recommended that the diagnosis criteria for a "disability" are instead legislated and included by way of introducing a new Schedule to the Income Tax Act; the Twelfth Schedule. From a practical point of view, the ITR-DD form could still be used to confirm that the diagnosis criteria as set out in that Schedule are met.

4.2.2 Paragraph (c) of the definition of "qualifying medical expenses" as contained in section 6B

"Qualifying medical expenses" means –

any expenditure that is [**prescribed by the Commissioner**] set out in paragraph 2 of the Twelfth Schedule (other than expenditure recoverable by a person or his or her spouse)

necessarily incurred and paid by the person during the year of assessment in consequence of any physical impairment or disability suffered by the person, any dependant of the person.

Explanation of the recommendation:

As in the case of the Commissioner having the power to prescribe the diagnosis criteria for a "disability", it is recommended that the Commissioner no longer be afforded the authority to dictate which expenses may qualify as having been incurred in consequence of physical impairment or "disability". Instead, a list of qualifying expenditure items could be included in a paragraph in the recommended Twelfth Schedule to the Income Tax Act. The list should state that it is not exhaustive, provide for broad categories of expenditure and provide a few examples within each category. Notwithstanding this recommendation, it is proposed that a better solution would be for the words "prescribed by the Commissioner" to be removed from paragraph (c) of the definition of "qualifying medical expenses" and no words added. The effect would be that any expense that the taxpayer is able to prove was necessarily incurred and paid in consequence of a physical impairment or "disability" would be eligible. The onus would be on the taxpayer in terms of section 102 of the Tax Administration Act, 28 of 2011, to prove that the particular expense item met such criteria and the Commissioner would be tasked with determining whether that onus has been discharged on a case-by-case basis. The key argument for the removal of the Commissioner's authority to prescribe a list of qualifying expenditure items is that currently the Commissioner is able to disallow legitimate expenses that a taxpayer has incurred in consequence of a physical impairment or "disability" on the grounds that the expense is not listed on the prescribed list. Over time, new technologies are developed, medical breakthroughs occur, new specialist services emerge and a situation may arise where a taxpayer incurs an expense that is not included on the outdated SARS list. It is submitted that a system whereby the taxpayer should be placed in a position of proving to the Commissioner that an expense has been legitimately incurred is better than a rigid definitive prescribed list made by the same party that is charged with enforcing that list.

4.2.3 <u>Paragraphs 3(a) and 3(b) of section 6B</u>

The amount of the additional medical expenses tax credit must be –

[**(a) where the person is entitled to a rebate under section 6(2)(b), the aggregate of-**

i) 33,3 per cent of so much of the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as

exceeds three times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and

ii) 33,3 per cent of the amount of qualifying medical expenses paid by the person;]

b) where the person is entitled to a rebate under section 6(2)(b) or where the person, his or her spouse or his or her child is a person with a disability, the aggregate of-

i) 33,3 per cent of so much of the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as exceeds three times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and

ii) 33,3 per cent of the amount of qualifying medical expenses paid by the person;

Explanation of the recommendation:

The additional medical expenses tax credit is calculated in the same manner for a person who is older than 65 as for a person who has "disability" or whose child or spouse has a "disability". Accordingly, it is recommended that paragraph (a) is removed from section 6B(3) of the Income Tax Act as the mere insertion of a few words into paragraph (b) of that section would make paragraph (a) redundant. Notwithstanding this recommendation, it is submitted that the legislature may have elected to keep both paragraphs to allow for easy amendments to be made to the relief that is applicable to the two different groups of taxpayers.

4.2.4 Paragraph (b) of the definition of "qualifying medical expenses" as contained in section 6B

"Qualifying medical expenses" means –

[**(b) any amounts (other than amounts recoverable by a person or his or her spouse) which were paid by the person during the year of assessment in respect of expenditure incurred outside the Republic on services rendered or medicines supplied to the person or any dependant of the person, and which are substantially similar to the services and medicines contemplated in paragraph (a).**]

Explanation of the recommendation:

It is recommended that paragraph (b) of the definition of "qualifying medical expenses" is repealed. It is submitted that paragraph (a) does not prohibit the deduction of expenditure as contemplated in that paragraph on the basis of the fact that such expenditure was incurred outside South Africa. Accordingly, the inclusion of paragraph (b) of the definition of "qualifying medical expense" is unnecessary as any expense that would meet the requirements of that paragraph should meet the criteria set out in paragraph (a) of that definition. Paragraph (b) even states that the expense should be "*substantially similar to the services and medicines contemplated in paragraph (a)*".

4.2.5 Paragraph 3(b) of section 6B

The amount of the additional medical expenses tax credit must be –

b) where the person or any dependant of the person, [**his or her spouse or his or her child**] is a person with a disability, the aggregate of-

i) 33,3 per cent of so much of the amount of the fees paid by the person to a medical scheme or fund contemplated in section 6A(2)(a) as exceeds three times the amount of the medical scheme fees tax credit to which that person is entitled under section 6A(2)(b); and

ii) 33,3 per cent of the amount of qualifying medical expenses paid by the person;

Explanation of the recommendation:

Currently, where a taxpayer incurs qualifying medical expenses for a dependant who is a person with a "disability" but who is not the taxpayer's spouse or child, the taxpayer is only entitled to tax relief in respect of such expenditure that exceeds 7,5 per cent of the taxpayer's taxable income. The tax credit is calculated as 25 per cent of that amount and not 33,3 per cent of the full amount of the expenditure as in the case of a dependant who is a child or spouse of the taxpayer. It is submitted that a key reason for the applicable tax relief being available is that the taxpayer eases the burden on the fiscus by incurring the cost of taking care of the person with the disability. In the case where the taxpayer incurs such cost for a dependant who is not his or her child or spouse, for example, his or her sibling, foster child, parent or parent-in-law, the taxpayer is still assisting the state. Accordingly, it is

recommended that the scope of the available tax relief at 33.3% with no reference to the taxpayer's taxable income be broadened to include any dependant of the taxpayer. Where a taxpayer has assumed a duty of financial support for a person with a disability, that taxpayer should be entitled to the applicable tax relief and the relationship between the taxpayer and that person should not prohibit the taxpayer from receiving that relief.

4.2.6 Paragraph (a) of the definition of "qualifying medical expenses" as contained in section 6B

"Qualifying medical expenses" means –

any amounts (other than amounts recoverable by a person or his or her spouse) which were paid by the person during the year of assessment to any duly registered –

(i) person who is registered with the Health Professions Council of South Africa, Allied Health Professions Council of South Africa, South African Pharmacy Council or South African Nursing Council,[**medical practitioner, dentist, optometrist, homeopath, naturopath, osteopath, herbalist, physiotherapist, chiropractor or orthopaedist**] for professional services rendered or medicines supplied to the person or any dependant of the person;

(ii) nursing home or hospital or any **[duly registered or enrolled nurse, midwife or nursing assistant (or to any]** nursing agency in respect of the services of **[such]** a nurse, midwife or nursing assistant **[)]** in respect of the illness or confinement of the person or any dependant of the person; or

[(iii) pharmacist for medicines supplied on the prescription of any person mentioned in subparagraph (i) for the person or any dependant of the person].

Explanation of the recommendation:

Further to the discussion in Chapter Two in respect of the distinction between a medical practitioner and other professionals, it is recommended, for sake of clarity, that subparagraph (a) (i) of the definition of "qualifying medical expenses" is amended to state the regulatory bodies whose members are considered to be duly registered medical practitioners instead of listing a few professions, especially given the ambiguity of the term "medical practitioner". By making the amendment, the expense would be allowed, provided it was paid to a duly registered person who is registered with one of the stated regulatory bodies. As pharmacists would be included as persons who are registered with the South African Pharmacy Council

and because subparagraph (a)(i) allows for services and medicines, subparagraph (a)(iii) would be redundant and could be repealed. It is also recommended that subparagraph (a)(ii) of the definition of "qualifying medical expenses" be amended as illustrated above as payments to a duly registered nurse, midwife or nursing assistant would be covered by the amended subparagraph (a)(i). For sake of clarity, payments to a nursing agency would not be removed from subparagraph (a)(ii). It should be noted that if these amendments were made as well as the previous recommendation with regard to removal of paragraph (b) of the definition of "qualifying medical expenses", then a further amendment would need to be made to subparagraph (a)(i) to include payments made to service providers outside of the Republic.

4.2.7 Paragraph (a) of the definition of "special trust" as contained in section 1

"Special trust" means

a trust created

(a) solely for the benefit of one or more persons who is or are persons with a disability as defined in section 6B(1) where such disability incapacitates or is expected to incapacitate such person or persons from earning sufficient income for their maintenance, or from managing their own financial affairs.

Explanation of the recommendation:

A strict interpretation of the requirement that the person's "disability" needs to incapacitate the person from earning a sufficient income for his or her maintenance or managing his or her own financial affairs would mean that a special trust could only be created for a child once the child has attained an age or maturity where it can be said for certain that it is the "disability" that is incapacitating the child from achieving such outcomes. Prior to reaching such age or maturity it could be said that the child's lack of development, education, experience or laws preventing a child from gaining employment are what incapacitated the child and not necessarily his or her "disability". Accordingly, it is recommended that the definition a special trust that is created for the sole benefit of a person with an incapacitating "disability" is amended to allow for the trust to be created for a person who has a "disability" that is expected to incapacitate them from earning sufficient income or managing his or her own financial affairs in the future. For example, with the recommended amendment, a special trust could be created for a child born with severe mental retardation at any date after the

child's date of birth and it would not be necessary to wait until the requirement is met that the person has a "disability" that presently incapacitates him or her in the stated manner. The amendment would also accommodate situations where a person has a regressive condition that will incapacitate them more in the future than it does presently. This amendment will require an element of subjectivity in determining whether the person is expected to be incapacitated in the future; it is submitted that a medical practitioner's prognosis should be considered in this regard based on evidence of people who have experienced a similar "disability".

4.2.8 Paragraph 2(b) of section 6A

The section 6A medical scheme tax credit amount is set out in paragraph 2(b) of section 6A of the Income Tax Act. It is recommended that this credit is increased to be more in line with the rate at which medical scheme contributions are increasing.

Explanation of the recommendation:

In terms of the discussion in Chapter Three, the average annual increase in medical scheme contributions is approximately 10%. In contrast, the average annual increase in the section 6A medical scheme tax credit is approximately, 5.5%. Accordingly, to ensure that the tax relief in respect of medical scheme is not eroded on an annual basis in real terms, it is recommended that future increases to the section 6A medical scheme tax credit are made with reference to medical scheme contribution inflation instead of CPI.

4.2.9 Paragraph 2(b) of section 6A

The amount of the medical scheme fees tax credit must be –

(i) R257, in respect of benefits to the person or one dependant;

(ii) R514, in respect of benefits to the person and one dependent or in respect of benefits for two dependants; or

(iii) R514, in respect of benefits to the person and one dependent or in respect of benefits for two dependants, plus R172 in respect of the benefits to each additional dependant,

For each month in that year of assessment in respect of which those fees are paid.

Explanation of the recommendation:

It was discussed in Chapter Two that a situation could arise where a taxpayer pays the medical scheme fees for their dependant(s), yet they do not pay their own medical scheme contributions; it could be that they are either not covered by a medical scheme themselves or they are a dependant on someone else's medical scheme. In such a situation, the taxpayer has not paid any medical fees "*in respect of benefits to the person*"; instead, they have only paid medical scheme fees in respect of one or more dependants. It is submitted that it unlikely that the legislature intended to exclude such taxpayers from receiving the section 6A tax credit and that the above recommendation would ensure that the legislation takes such situations into consideration.

4.3 Limitations of the research

When gauging the extent to which medical schemes provide coverage in respect of costs incurred in consequence of a person's physical impairment or disability, surveys were submitted to twenty different medical schemes. Despite continuous follow-ups and extensive efforts to retrieve completed surveys from the schemes, only two medical schemes responded. It was decided that this limited response was insufficient to be able to draw conclusions from and thus this information was not used in the present research.

4.4 Opportunities for further research

The present paper has focused on the South African tax legislation that is applicable to taxpayers who have a physical impairment or "disability". The paper has provided a critical analysis of that legislation and has recommended amendments where it is believed the current legislation falls short. The present research has also considered the extent to which medical schemes provide coverage in respect of the costs incurred in consequence of physical impairment or disability in an effort to highlight the importance of the applicable tax relief. Through conducting this research, it became apparent that there are several opportunities to conduct further research that was beyond the scope or limitations of the present research.

South Africa's shift from a medical deduction to a medical credit is largely based on the Canadian tax legislation which undertook a similar transition several years earlier. Accordingly, there is an opportunity to research the Canadian tax legislation applicable to

persons with a physical impairment or "disability" to draw comparisons and to extract lessons for possible amendments to the South African legislation.

The present paper assumes that the contents of the ITR-DD (Confirmation of Diagnosis of Disability) form are relevant and acceptable. There is an opportunity for further research whereby specialist medical practitioners could be surveyed to determine whether they are satisfied with the diagnosis criteria as set out on the form. For example, a group of mental health care practitioners could be surveyed to establish whether they are of the opinion that the "mental" section of the form is practical and applicable when determining whether someone is considered to have a mental "disability". This research could also identify any problems that medical practitioners encounter in general when completing the form.

As indicated in Chapter One, South Africa lacks accurate and reliable data with regard to the prevalence of disability in the country. There is an opportunity for research to be undertaken which seeks to provide an acceptable definition of the term "disability" and to investigate how many people in the country can be said to have a "disability" as defined. This information is valuable to government as such data is needed when determining certain aspects of service delivery and welfare.

Further to the opportunity to research the prevalence of disability in South Africa is the opportunity to research the uptake of the applicable tax relief available to qualifying taxpayers. The present paper indicated that the current uptake appears to be insignificant in relation to the anticipated prevalence of disability in the country; however, there is an opportunity to research the uptake of the applicable tax relief in relation to the prevalence of disability.

A limitation of the present research was an inability to survey medical schemes to obtain information in respect of the scheme's policies pertaining to disability and the true extent of the coverage that medical schemes provide in respect of the expenditure incurred in consequence of a person's physical impairment or disability. The present paper indicated that a medical scheme is only likely to cover medical expenses incurred in consequence of disability, for example, occupational therapy, sessions with a psychologist, prescription medication, or prosthetic limbs. It was further indicated that a medical scheme is unlikely to cover expenditure incurred in consequence of a person's disability that is not of a medical nature, for example, personal attendant care, travel, special needs school fees and various aids and devices. There is an opportunity to research the extent to which medical schemes will

cover the medical expenses; for example, the limits placed on the claims that may be made, whether the person's disability affects the coverage they receive, waiting periods or exclusions imposed by medical schemes and whether a person's disability influences such impositions, and how medical schemes define "disability" and what difference it makes if a member has such "disability".

The present paper highlights the fact that medical scheme contributions increase at a rate that is significantly higher than standard inflation. It is submitted that the likely cause for this is that medical costs increase faster than the cost of the goods that are measured in the CPI. Accordingly, there is an opportunity to research the reasons for the rapid rise in medical costs and what could be done to curb those medical inflation drivers.

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