**INTERPRETATION NOTE 121**

DATE: 13 June 2022

**ACT : INCOME TAX ACT 58 OF 1962**
**SECTION : SECTION 12M**
**SUBJECT : DEDUCTION OF MEDICAL LUMP-SUM PAYMENTS**

**Contents**



***Preamble***

In this Note unless the context indicates otherwise –

- **“dependant”** in relation to a former employee, means a spouse or dependant as defined in section 1 of the Medical Schemes Act 131 of 1998 (see **4.2.5(c)**);
- **“former employee”** means a former employee as defined in **4.2.5(a)**;

- **"insurer"** means an insurer as defined in "Policy of insurance" in **4.2.5(d)**;
- **"medical fund"** means a medical fund as defined in "Contributions to medical scheme or fund" in **5**;
- **"medical scheme"** means a medical scheme as defined in "Contributions to medical scheme or fund" in **5**;
- **"post-retirement medical benefits"** means contributions to a registered medical scheme registered under the Medical Scheme Act 131 of 1998, or a fund which is registered under any similar provision contained in the laws of any other country where the medical scheme is registered;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All interpretation notes referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issues of these documents should be consulted.

## 1. Purpose

This Note provides guidance on the interpretation and application of section 12M which relates to the deductibility of a lump-sum amount paid by a taxpayer to or in respect of a former employee or dependants of that former employee for purposes of covering post-retirement medical benefits. The income tax implications of this benefit to the former employee are not considered in this Note.

## 2. Background

Employers often provide various incentives to attract and retain employees with scarce skills. One form of benefit is to cover the medical aid contributions of former employees in retirement. This could be an expensive and risky exercise for a taxpayer as medical inflation may exceed general inflation, or a chronic illness of a former employee can be protracted.[1] In order to counter such a risk, taxpayers may seek to settle this liability upfront. Two common approaches to settling the liability upfront are to make a lump-sum payment to an insurer for a policy of insurance or to make a direct lump-sum payment to the former employee or dependant. Depending on the facts, the taxpayer may transfer their contractual responsibility to provide post-retirement medical benefits to the insurer, former employee or dependant.

Previously the tax treatment of a lump sum paid by a taxpayer to cancel the obligation to provide for the post-retirement medical benefits of a former employee was uncertain and arguably not deductible. Since the introduction of section 12M, a taxpayer can claim an immediate deduction of a lump-sum payment made for purposes of covering the post-retirement medical aid contributions of a specified former employee or dependant if it meets the requirements which are listed in **4.1** of this Note.

## 3. The law

The relevant sections of the Act are quoted in the **Annexure**.

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[1] Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009.

## 4. Application of the law

### 4.1 Introduction

Section 12M provides for a deduction if –

- an amount is paid by the taxpayer (see **4.2.1**);
- by way of a lump sum (see **4.2.2**);
- during the taxpayer's year of assessment (**4.2.3**);
- in the course of the taxpayer's trade (**4.2.4**);
- to –
  - any former employee who retired from the taxpayer's employment on the grounds of old age, ill-health or infirmity or to any dependant of such former employee (see **4.2.5**), or
  - an insurer under a policy of insurance taken out solely in respect of one or more of the above-mentioned former employees or their dependants (see **4.2.5**); and
- to the extent it is paid for the purpose of making any contribution to a medical scheme or a medical fund in respect of such former employee or his or her dependants.

The deduction is limited to the extent that the lump-sum payment is for the purpose of making a contribution to a medical scheme or medical fund in respect of the above-mentioned former employee or dependant. No deduction is allowed if the taxpayer or any connected person[2] in relation to the taxpayer retains or has a future obligation as relates to the mortality risk of the above-mentioned former employee or dependant (see **6**).

Section 23(*e*) does not prohibit a deduction under section 12M.

### 4.2 Discussion of the requirements

#### 4.2.1 Amount is paid

It is well accepted that the word "amount" has a wider meaning than money. The meaning of the word "amount" was considered in *WH Lategan v CIR*[3] in relation to the definition of "gross income". Watermeyer J explained that:

> "In his Lordship's opinion, the word 'amount' must be given a wider meaning and must include not only money but the value of every form of property earned by the taxpayer whether corporeal or incorporeal, which has a money value."

*C: SARS v Brummeria Renaissance (Pty) Ltd and Others* confirmed that the law is as follows:[4]

> "The law in South Africa appears from the following passage in the *People's Stores* case:
>
> > 'The first and basic proposition [in *Lategan*'s case] is that income, although expressed as an *amount* in the definition, need not be an actual amount of money but may be "every form of property earned by the taxpayer, whether

[2] Defined in section 1(1). See Interpretation Note 67 "Connected Persons" for a comprehensive consideration of the subject of connected person.

[3] 1926 CPD 203, 2 SATC 16 at 19.

[4] 2007 (6) SA 601 (SCA), 69 SATC 205 at 214.

> corporeal or incorporeal, which has a money value . . . including debts and rights of action”.
>
> This proposition is obviously correct so that very little need be added to what Watermeyer J himself said in support thereof. It is hardly conceivable that the Legislature could not have been aware of, or would have turned a blind eye to, the handsome profits often reaped from commercial transactions in which money is not the medium of exchange. Consider, for example, the many instances of valuable property changing hands, not for money, but for shares in public or private companies; or share-cropping agreements, dividends in the form of bonus shares, or *remuneration for services in the form of free or subsidised housing* and the use of motor vehicles. These are only a few of the many possible illustrations that readily come to mind and which, as we know, have not been overlooked by the Legislature.’ ”

Although the cases mentioned above dealt with the definition of “gross income”, the principles apply equally in determining what constitutes an “amount” for purposes of section 12M. Accordingly, it is clear that payment of a lump sum includes payment of a sum of money and payment in a form other than money. Payment in a form other than money must, however, be of such a nature that a value in money can be attached to it. The question whether an amount in a form other than money has a money value is the primary question which must be determined on an objective basis. Whether such amount can be turned into money is but one of the ways in which its monetary value can be determined. It does not follow that if an amount cannot be turned into money, it has no money value.[5]

A deduction under section 12M may be claimed only when an amount has been paid and not if it is incurred but not paid. An amount will be considered to be “paid” if actual payment of the full lump sum is made to the former employee, his or her dependants, or to an insurer (see **4.2.5**).

Section 12M does not prescribe a maximum amount which may qualify for deduction, therefore provided all of the requirements (see **4.1**) are met the full amount of the lump sum will qualify for deduction in the year of assessment in which it is paid.

**Example 1 – Amount paid by the taxpayer after the year of assessment**

*Facts:*

The employment contract between Company J and Employee S provided for post-retirement medical benefits. Employee S retired from the employ of Company J on 31 January 2022 after reaching the compulsory retirement age of 65 years. Company J and Employee S agreed that Company J’s obligation for post-retirement medical benefits would be terminated if Company J paid Employee S a lump sum intended to be used by Employee S to cover future medical aid premiums. Employee S would assume responsibility for making the contributions. The agreement pertaining to the termination of Company J’s post-retirement medical benefit obligation was concluded in February 2022 while the payment of lump sum occurred in March 2022. Company J’s year of assessment ends in February.

5 *C SARS v Brummeria Renaissance (Pty) Ltd and Others* 2007 (6) SA 601 (SCA), 69 SATC 205 at 214.

*Result:*

One of the requirements under section 12M(2) is that the lump sum must be paid during the year of assessment. Company J will not be entitled to a deduction under section 12M in the 2022 year of assessment for the lump-sum expense relating to post-retirement medical benefits because even though the expense was incurred during the 2022 year of assessment, it was not paid. The lump sum was paid in March 2022 and therefore this requirement will be met in the 2023 year of assessment.

### 4.2.2 Lump sum

The word "lump sum" is not defined in the Act and as such it has to be given its ordinary meaning having regard to the context in which it is used in section 12M. *Lexico Dictionaries* defines the word "lump sum" as follows: [6]

> "a single payment made at a particular time, as opposed to a number of smaller payments or instalments."

Payment by way of instalments over a period of time, or by more than one payment, will therefore not qualify as a lump sum. Similarly, monthly or periodical payments do not qualify as an amount paid by way of a lump sum. A lump-sum payment is considered a "once-off" payment made on a single occasion. For example, if a taxpayer partially discharges an obligation to pay an agreed amount with the outstanding balance to be settled by a separate payment in the same or a following year of assessment, none of the amounts paid will constitute an "amount paid by way of lump sum" as required in section 12M(2).

**Example 2 – Amount paid by the taxpayer as a lump sum**

*Facts:*

Company B covers the post-retirement medical aid contributions of a former Employee P by way of making a once-off payment of R500 000 to Employee P on 31 March 2023. Employee P retired due to ill health. Company B's year of assessment ends in June.

*Result:*

The amount of R 500 000 is an amount paid as a lump sum and would therefore be a lump-sum payment for the purpose of section 12M.

**Example 3 – Amount paid by the taxpayer as a periodical payment**

*Facts:*

Company G covers the post-retirement medical aid contributions of a former employee, who retired due to old age, by making a monthly payment of R5 000 to the former employee.

*Result:*

The monthly payments of R5 000 do not constitute a lump-sum payment and therefore do not qualify for deduction under section 12M.

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[6] **www.lexico.com/definition/lump_sum** [Accessed 13 June 2022].

**Example 4 – Transfer of mortality risk of former employees or their dependants to an insurer in tranches**

*Facts:*

Company B covers the post-retirement medical aid contributions of 30 eligible employees who retired due to old age. In year 1 Company B entered into a policy of insurance with GE Insurers, an insurer as defined in section 29A, under which Insurer G assumed full responsibility for all future medical aid scheme contributions for 20 of the 30 eligible former employees, or a dependant of such former employee. Company B paid Insurer G a lump-sum premium of R15 000 000. The 20 employees that the policy covered were part of negotiations and agreed to the transfer of the responsibility to Insurer G.

In year 2 Company B concluded a new insurance policy with Insurer G covering the remaining 10 employees who qualified for post-retirement medical aid benefits and had retired due to old age. Insurer G assumed full responsibility for all future medical aid scheme contributions for the 10 former employees, or a dependant of such former employee. Company B paid Insurer G a lump-sum premium of R8 000 000. The 10 employees the policy covered were part of negotiations and agreed to the transfer of the responsibility to Insurer G.

*Result:*

The R15 000 000 and R8 000 000 paid in year 1 and year 2 directly to Insurer G by Company B was to cover the full obligation of post-retirement medical aid contributions of the 20 and 10 former employees or dependants of such former employees, respectively. The payment of R15 000 000 and R8 000 000 constitute separate lump-sum payments for different policies and different groups of former employees for the purpose of section 12M, and is not considered a single lump sum paid in instalments. If all the other requirements of section 12M are met, Company B will qualify for the deduction of the lump-sum payments under section 12M in year 1 and 2, respectively.

### 4.2.3 Year of assessment

The term “year of assessment” is defined in section 1(1) and means:

> “any year or other period in respect of which any tax or duty leviable under [the] Act is chargeable”. Further “any reference in [the] Act to any year of assessment ending the last or the twenty-eighth or the twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company or a portfolio of a collective investment scheme in securities be construed as a reference to any financial year of that company or portfolio ending during the calendar year in question”.

If an employee retires in one year of assessment and the taxpayer pays the lump sum to, for example, the former employee in a subsequent year of assessment, the taxpayer can only claim the deduction under section 12M, assuming all the requirements of the section are met, in the subsequent year of assessment that the lump-sum amount is paid to the former employee (see **4.2.1**).

### 4.2.4 Carrying on of a trade

Under section 12M the taxpayer is required to carry on a trade during the year of assessment and to make a lump-sum payment as discussed in this Note as part of that trade.

The term "trade" is widely defined in section 1(1) as including –

> "every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature".

The Court held in *Burgess v CIR*[7] that:

> "It is well-established that the definition of trade, which I have quoted above, should be given a wide interpretation. In ITC 770(1953) 19 SATC 216 at p 217 Dowling J said, dealing with the similar definition of 'trade' in Act 31 of 1941, that it was 'obviously intended to embrace every profitable activity and . . . I think should be given the widest possible interpretation."

The term "trade" covers a wide spectrum of activities, however, it does not include all activities that might produce income. For example, watching over investments or earning interest on funds advanced by a holding company to its subsidiary will not constitute a trade. However, if a person's investing activities are a business of moneylending or share-dealing, it would constitute a trade.

The facts and circumstances of each case must be considered in assessing if a person is carrying on a trade and if that person made a lump-sum payment as considered in this Note during the course of that trade.

### 4.2.5 Person to whom the payment must be made

The lump sum must be paid to –

- any former employee who retired from the taxpayer's employment on the grounds of old age, ill-health or infirmity or to any dependant of such former employee, or
- an insurer under a policy of insurance taken out solely in respect of one or more of the above-mentioned former employees or their dependants.

#### (a) Meaning of "former employee"

The words "former", "employee" and "employ" are defined in the *Lexico Dictionaries,* respectively as:

> "[H]aving previously been a particular thing." [8]
>
> "A person employed for salary or wages, especially at non-executive level."[9]
>
> "Give work to (someone) and pay them for it."[10]

7 1993 (4) SA 161 (A), 55 SATC 185 at 196.
8 **www.lexico.com/definition/former** [Accessed 13 June 2022].
9 **www.lexico.com/definition/employee** [Accessed 13 June 2022].
10 **www.lexico.com/definition/employ** [Accessed 13 June 2022].

Therefore, a person must have been an employee of the taxpayer in order to be a "former employee" after the termination of the employee and employer relationship.

The definition of "employee" as contained in the Fourth Schedule to the Act, which is applicable when determining the employees tax to be deducted or withheld by an employer, is wider than the definition applicable for the purpose of section 12M (see above). For example, depending on the facts, a consultant that provides services to the taxpayer on a fixed term contract may be an employee for employee's tax purposes but would not be a former employee of the taxpayer for purposes of section 12M once the fixed term contract expires.

### (b) Retired due to "old age", "ill health" or "infirmity"

Section 12M requires an employee to have retired from the taxpayer's employ due to old age, ill health or infirmity. The words "retire", "old age", "ill-health" and "infirmity" are not defined in the Act, thus the words should be interpreted according to their ordinary dictionary meaning as applied to the subject matter with regard to which they are used.[11]

The words "retire", "old age", "ill health" and "infirmity" are defined in the *Lexico Dictionaries,* respectively as follows:

> "Leave one's job and cease to work, typically on reaching the normal age for leaving service."[12]
>
> "The later part of normal life." [13]
>
> "Poor physical or mental condition."[14]
>
> "Physical or mental weakness."[15]

The word "infirmity" is defined in the *Oxford Dictionary, Thesaurus, and Wordpower Guide* as follows:

> "noun **1** *they were excused due to infirmity*: FRAILTY, weakness, feebleness, delicacy, debility, decrepitude, disability, impairment, illness, sickness, indisposition, poor health…"[16]

In interpreting the above-mentioned words and assessing whether an employee has retired from a taxpayer's employ on the grounds of old-age, ill-health or infirmity, the dictionary definitions in isolation do not provide the answer. The context in which the words are used is important[17] and indicates that the rules and regulations that govern retirement at the particular taxpayer, for example, an employee's contract of employment, the taxpayer's applicable retirement-related policies and procedures, and the retirement fund rules, must be considered as well as relevant legislation (if any). The facts and circumstances of the particular case must then be objectively considered to assess whether the employee has a) retired and b) if so, has retired on the grounds

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11 See E A Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworths, South Africa Series. See also Lucas Cornelius Steyn *Die Uitleg van Wette* 5 ed (1981) Juta en Kie., Bpk at pages 4 – 7.

12 **www.lexico.com/definition/retire** [Accessed 13 June 2022].

13 **www.lexico.com/definition/old_age** [Accessed 13 June 2022].

14 **www.lexico.com/definition/ill_health** [Accessed 13 June 2022].

15 **www.lexico.com/definition/infirmity** [Accessed 13 June 2022].

16 C Soanes & M Waite *Oxford Dictionary, Thesaurus, and Wordpower Guide* 2 ed (2001) Oxford University Press in vol 1.

17 See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at 603. See also *C: SARS v Bosch and Another* 2015 (2) SA 174 (SCA); 77 SATC 61 at 74.

of old age, ill health or infirmity. For example, Employer A's rules and regulations governing retirement provide for a mandatory retirement age of 65 years only. If a healthy employee who is 60 years old leaves Employer A's employment it cannot be a retirement due to old age as retirement at 60 years is not permitted. However, if the applicable rules and regulations as contained in, for example, the conditions of employment, the taxpayer's applicable retirement-related policies and procedures, and the applicable retirement fund rules, provide that an employee may retire at the age of 60 years with or without triggering a penalty clause, notwithstanding the mandatory retirement age is 65 years, then an employee who retires at the age of 60 years in terms of the rules and regulations governing retirement from Employer A will fall within the ambit of retirement due to "old age". Alternatively, if the rules and regulations governing retirement permit an employee to retire due to ill health in specified circumstances then the employee may fall within the ambit of retirement due to "ill health". The variations and complexities of the particular rules and regulations must be considered. Taxpayers bear the onus of proving the payment of the relevant lump sum was to an employee who, based on all the facts and circumstances of the particular case, retired due to old age, ill-health or infirmity.

In the absence of policies and procedures specifying the circumstances under which an employee may qualify for retirement on the grounds of ill-health or infirmity, the specific medical condition affecting the employee must be considered objectively. The medical condition will be assessed in relation to the type of work the employee is required to perform, for example if an employee, who is required to operate heavy machinery as a requirement of the employment, suffered a stroke and loses the use of his or her limbs, they may be able to retire due to ill-health or infirmity depending on the detailed policies and procedures. It should be noted that ill-health is not only confined to a physical disability, but can also be the result of a mental condition.

The employee must have retired due to old age, ill health or infirmity. This requirement will not be met if, for example, the employee is granted extended sick leave but returns to work after that extended sick leave or if the employee for some reason resigns from the taxpayer's employment. In both of these examples the employee has not retired. In addition, if the employee retires for any reason other than old age, ill-health or infirmity, a deduction under section 12M will not be allowed.

**Example 5 – Retirement on grounds of ill health**

*Facts:*

Company V's rules and regulations governing retirement stipulate that an employee's employment contract automatically terminates once the employee attains the age of 65 years, which is considered to be retirement age. The rules and regulations also provide for the possibility of retirement from the age of 55 years for, amongst others, reasons of ill health. Employee E was involved in a motor vehicle accident and as a result sustained severe injuries which negatively impacted Employee E's health. As a consequence Employee E retired on 31 March 2022 at the age of 60 years.

*Result:*

For purposes of section 12M, whether Employee E's retirement was due to old age, ill health or infirmity must be considered in relation to the Company V's rules and regulations governing retirement. The normal retirement age for Company V's employees' is 65 years, therefore retirement at 60 years is not a retirement due to old age. However, because the rules and regulations governing retirement permit retirement as a result of ill health from the age of 55 years and this was the basis on which Employee E retired at the age of 60, the requirement of retiring due to ill health under section 12M will be met.

**Example 6 – Retirement on grounds of old age**

*Facts:*

Company R's rules and regulations governing retirement stipulate that an employee's employment contract automatically terminates once the employee attains the age of 60 years, which is the mandatory retirement age. The rules and regulations governing retirement allow an employee to elect to retire from the age of 55 years, however, a penalty will be triggered under the retirement fund rules. Employee E retired on 31 August 2021 at the age of 55 years.

*Result:*

For purposes of section 12M, whether Employee E's retirement was due to old age must be considered in relation to the Company R's rules and regulations governing retirement. Although the mandatory retirement age per Company R's rules and regulations governing retirement is 60 years, the rules and regulations permit an employee to retire from the age of 55 years. Accordingly, Employee E's retirement at the age of 55 years under the rules and regulations governing retirement meets the requirement of retiring due to old age under section 12M. This is not altered by the fact that a penalty was triggered, since Employee E retired at the age of 55 years.

### (c) Meaning of "dependant"

A "dependant" in relation to a former employee is defined in the preamble to this Note and section 12M(1) as "a spouse or dependant as defined in section 1 of the Medical Schemes Act 131 of 1998".

"Spouse" is defined in section 1(1) in relation to any person as –

> **"**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 is intended to be permanent, …"

"Dependant" is defined in section 1 of the Medical Schemes Act 131 of 1998 as –

> "(*a*) the spouse or partner, dependant 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 a member"

#### (d) Policy of insurance

Under section 12M(2)(*b*), the taxpayer may make the lump-sum payment to an insurer under a policy of insurance taken out solely in respect of one or more former employees (see **4.2.5(a)**), or their dependants (see **4.2.5(c)**).

The policy of insurance must be taken out with an insurer as defined in section 29A.[18] Section 29A defines an insurer as a company that is licensed under the Insurance Act[19] and is conducting life insurance business as defined in that Act ,[20] other than a foreign reinsurer[21] conducting insurance business through a branch in the Republic in terms of section 6 of that Act.

A policy of insurance taken out by a former employer may cover the future medical scheme or medical fund contributions of one or more former employees or their dependants.

## 5. Contributions to medical scheme or fund

The taxpayer will only be able to claim a deduction under section 12M to the extent the lump sum is paid for the purpose of making a contribution in respect of a former employer or dependant as referred to in **4.2.5(c)**, to a medical scheme or fund as contemplated in section 6A(2)(*a*)(i) or (ii). This section refers to –

- a medical scheme which is registered under the Medical Schemes Act ("medical scheme");[22] or
- a fund which is registered under any similar provision contained in the laws of any other country where the medical scheme is registered ("medical fund").[23]

The taxpayer has the obligation to determine whether the legislation governing such foreign scheme is similar to the provisions contained in the said Medical Schemes Act.

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18 Section 12M(1).

19 Act 18 of 2007.

20 "[L]Ife Insurance Business" is defined in section 1 of the Insurance Act 18 of 2017 as "any activity conducted with the purpose of entering into or meeting insurance obligations under a life insurance policy". "[L]ife insurance policy" is also defined in section 1 of that Act.

21 Defined in section 1 of the Insurance Act 18 of 2017 and means an institution authorized and supervised by a regulatory authority to perform business similar to reinsurance business as defined in that Act under the laws of a country other than the Republic.

22 Section 6A(2)(*a*)(i).

23 Section 6A(2)(*a*)(ii).

**Example 7 – Amount paid to an insurer under a policy of insurance whereby the amount only partly relates to the future coverage for medical aid scheme**

*Facts:*

Company W entered into a policy of insurance with GE Insurers, an insurer as defined in section 29A. According to the policy of insurance if an employee retires on the ground of ill-health, Company W will make a lump-sum payment of R1 000 000 to GE Insurers. GE Insurers will assume the responsibility for all future medical aid scheme contributions of the former employee, or a dependant of such a former employee. In addition, GE Insurers will also contribute to a separate wellness product sold and administered by a separate company in the same group of companies as the medical scheme, which provides certain benefits to a former employee or a dependant of such former employee.

*Result:*

A deduction is permitted under section 12M only to the extent the amount paid by a taxpayer is for purposes of making contributions in respect of a former employee or dependant of such former employee to a medical aid scheme. Therefore, the amount deductible under section 12M will be limited to the portion of the lump sum related to the medical aid scheme contributions. The portion related to the contributions to the loyalty programme will not be deductible by the taxpayer under section 12M.

## 6. Exclusions

The deduction under section 12M(2) is subject to the proviso that the taxpayer or a connected person in relation to the taxpayer must not retain any further obligation, whether actual or contingent, relating to the mortality risk of the former employees or dependants of the former employee specified in **4.2.5(c)**.

The words "mortality" and "risk" are defined in *Lexico Dictionaries* as follows respectively:

> "1. The state of being subject to death."[24]
>
> " (usually risks) A possibility of harm or damage against which something is insured."[25]

The following explanation regarding "mortality risk" under section 12M was provided for the in the *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2009*:

> "Mortality risk refers to the risk concerning the longevity of the ex-employee. For instance, an employer may take out a policy on the premise that the relevant ex-employee will only live to the age of 75 years. The person then lives, contrary to expectations, to the age of 90. For the purpose of the proposed deduction, the risk of covering the unforeseen 15 years in these circumstances must fall on the insurer and not the employer (nor on a person connected to the employer)."

The mortality risk of a former employee or dependants of a former employee as specified in **4.2.5(c)** therefore relates to the risk involving the anticipated years such former employee or dependant of a former employee as specified in **4.2.5(c)** will live and accordingly for which the post-retirement medical aid benefits will need to be provided. Irrespective of whether the former employee or dependant of that former employee lives for, for example, 2 years or 20 years, the taxpayer or a connected

24 **www.lexico.com/definition/mortality** [Accessed 13 June 2022].

25 **www.lexico.com/definition/risk** [Accessed 13 June 2022].

person to the taxpayer must not have any actual or contingent obligation after the payment of the lump sum to pay the post-retirement medical aid contributions in respect of the relevant former employee or dependant of that former employee. If, for example, notwithstanding the payment of the lump sum to an insurer, the taxpayer still had the obligation or potential obligation to cover the medical contributions in the event that the insurer failed to pay then the employer would be carrying mortality risk and would not qualify for a deduction under section 12M. In the event that the taxpayer, or any connected person[26] in relation to the taxpayer (being the insurer or someone other than the insurer), retains or has any actual or contingent obligation to cover any future medical aid cost of a former employee or dependants of a former employee as specified in **4.2.5(c),** the taxpayer would not be entitled to a deduction under section 12M. The word "has" was included in the preceding sentence to clarify that in the context and wording of the section, if mortality risk was transferred to a connected person in relation to the taxpayer then the taxpayer and connected person as a collective retained the risk and accordingly the proviso prohibits a deduction.

**Example 8 – Amount paid to an insurer under a policy of insurance whereby the taxpayer retains the mortality risk of the former employee**

*Facts:*

Company Z makes a payment of R900 000 on 15 April 2021 to DEF Insurers, an insurer as defined in section 29A, in respect of the medical aid contributions of former Employee J. Employee J retired from Company Z on the grounds of ill-health. According to the policy of insurance Employee J's medical aid coverage is for a period equal to the shorter of the earlier of Employee J reaching the age of 75 years or his death. In the event that Employee J survives beyond the age of 75 years, Company Z will be responsible for the medical aid contributions after Employee J reaches this age.

*Result:*

The proviso to section 12M prohibits a deduction where a taxpayer retains an obligation, whether actual or contingent, in respect of the mortality risk of a former employee or dependant of such a former employee. In retaining the responsibility for further medical aid contributions if Employee J lives beyond the age of 75 years, Company Z has retained a contingent obligation for mortality risk relating to Employee J and is therefore be precluded from deducting the lump-sum payment under section 12M.

## 7. Transactions falling within sections 45

The scope of this Note does not consider all the effects of the application of the corporate rules contained in sections 41 - 47. However, a question which may arise frequently in the context of section 12M and the corporate rules is whether an employee who retired before a business, or a part of a business, was transferred as a going concern and to which transfer the provisions of section 45 were applied, will be regarded as a "former employee" of the transferee for purposes of section 12M(2)(*a*).

[26] Defined in section 1(1). See Interpretation Note 67 "Connected Persons" for a comprehensive consideration of the subject of connected person.

In circumstances where –

- under section 197 of the Labour Relations Act 66 of 1995 (the "LRA") the taxpayer, that is the transferee, is automatically substituted as the employer in the place of the transferor with regards to all contracts of employment of the employees in existence immediately before the date of the transfer of the business as a going concern;
- the parties did not contract out of the provisions of section 197(2) of the LRA;
- under the agreement all of the employer's contractual obligations relating to current and former employees were transferred to the transferee; and
- the provisions of section 45 were applied to the transfer of the business, or applicable part of a business, as a going concern;

employees who retired from transferor prior to the transfer of the business, or part of a business, and in respect of which transferor's obligation to pay post-retirement medical benefits to that employee or their applicable dependents was transferred to the transferee as part of the transfer as a going concern, will be regarded as a "former employee of the taxpayer" paying the lump sum for the purposes of section 12M.

## 8. Conclusion

A taxpayer may be entitled to claim a deduction in the year of assessment a lump-sum amount is paid for the purposes of covering post-retirement medical benefits of former employees or dependants of former employees under specified circumstances. A deduction under section 12M will be available if the lump sum is paid by the taxpayer during the taxpayer's year of assessment in the course of taxpayer's trade –

- to –
  - any former employee who retired from the taxpayer's employment on the grounds of old age, ill-health or infirmity or any dependant of such former employee, or
  - to an insurer under a policy of insurance taken out solely in respect of one or more of the above-mentioned former employees or their dependants; and

to the extent it is paid for the purpose of making any contribution to a medical scheme or medical fund in respect of such former employee or his or her dependants.

The deduction is limited to the extent that the lump-sum payment is for the purpose of making a contribution to a medical scheme or medical fund in respect of the above-mentioned former employee or dependant.

No deduction is allowed if the taxpayer or any connected person to the taxpayer retains or has any further obligation, whether actual or contingent, related to the mortality risk of the above-mentioned former employee or a dependant of the former employee.

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## Annexure – The law

## Section 12M

**12M. Deduction of medical lump sum payments.—**(1) For the purposes of this section —

**“dependant”**, in relation to a former employee, means a spouse or any dependant (as defined in section 1 of the Medical Schemes Act);

**“insurer”** means an insurer as defined in section 29A.

(2) In determining the taxable income derived by any taxpayer in any year of assessment from carrying on any trade, there must be allowed as a deduction from the income of that taxpayer so derived any amount paid by way of a lump sum during the year of assessment by that taxpayer —

(*a*) to any former employee of the taxpayer who has retired from the taxpayer’s employ on grounds of old age, ill health or infirmity or to any dependant of that former employee; or

(*b*) under any policy of insurance taken out with an insurer solely in respect of one or more former employees or dependants contemplated in paragraph (*a*),

but only to the extent that the amount is paid for the purposes of making any contribution, in respect of any former employee or dependant contemplated in paragraph (a), to any medical scheme or fund contemplated in section 6A(2)(*a*)(i) or (ii): Provided that no deduction may be allowed in terms of this section if the taxpayer making the payment, or a connected person in relation to that taxpayer, retains any further obligation, whether actual or contingent, relating to the mortality risk of any former employee or dependant contemplated in paragraph (a).

## Section 29A

**29A. Taxation of long-term insurers.**—(1) For the purposes of this section—

**“insurer”** means a company that is licensed under the Insurance Act and is conducting life insurance business as defined in that Act, other than a foreign reinsurer conducting insurance business through a branch in the Republic in terms of section 6 of that Act;

## Definition of “connected person”

**“connected person” means —**

(*a*) in relation to a natural person —

(i) any relative; and

(ii) any trust (other than a portfolio of a collective investment scheme) of which such natural person or such relative is a beneficiary;

(*b*) in relation to a trust (other than a portfolio of a collective investment scheme) —

(i) any beneficiary of such trust; and

(ii) any connected person in relation to such beneficiary;

(*b*A) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme), any other person who is a connected person in relation to such trust;

(*c*) in relation to a member of any partnership or foreign partnership —

(i) any other member; and

(ii) any connected person in relation to any member of such partnership or foreign partnership;

(*d*) in relation to a company —

(i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent of the equity shares in” in paragraphs (a) and (b) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent of the equity shares or voting rights in”;

(ii) . . . . . .

(iii) . . . . . .

(iv) any person, other than a company as defined in section 1 of the Companies Act that alone or together with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of —

(*aa*) the equity shares in the company; or

(*bb*) the voting rights in the company;

(v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;

(vA) any other company if such other company is managed or controlled by —

(*aa*) any person who or which is a connected person in relation to such company; or

(*bb*) any person who or which is a connected person in relation to a person contemplated in item (aa); and

(vi) where such company is a close corporation —

(*aa*) any member;

(*bb*) any relative of such member or any trust (other than a portfolio of a collective investment scheme) which is a connected person in relation to such member; and

(*cc*) any other close corporation or company which is a connected person in relation to —

(i) any member contemplated in item (aa); or

(ii) the relative or trust contemplated in item (bb); and

(*e*) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme in securities;