# Healthcare Industry Newsletter

**1 of 2021**

## In this issue



SIMEKA HEALTH

member of Sanlam group

# 01 Simeka Health unpacks the tax linked to medical scheme membership

The rules pertaining to medical scheme membership have evolved substantially over the past two to three decades. The current Medical Schemes Act first came into force in 1998. This was followed by the new, democratic South Africa in 1994 and the various subsequent developments towards a National Health Insurance system possibly to be implemented by 2025. One can understand that the tax regime linked to medical scheme membership would also change in tandem. These changes mainly focused on supporting social solidarity aspects.

Historically, the tax benefits to be derived from belonging to a medical scheme and assisting with additional expenses were:

## Up to 2005

Employees were not taxed on company-paid medical scheme contributions up to a maximum of two-thirds of such contributions. During this period, it was therefore the norm for companies to subsidise as much as two-thirds of medical scheme contributions. Any subsidy amounts exceeding two-thirds were taxed in the hands of the employee. The employers in turn, could not contribute more than 20% of salary bill towards medical scheme subsidies and pension fund contributions.

If you were self-employed, or did not receive a subsidy, you did not get any tax relief. However, on the medical expenses side, you could deduct qualifying expenses exceeding 5% of taxable income. Persons older than 65 years could deduct all expenses and handicapped persons could deduct all expenses exceeding R500 per annum.

## 2006 to 2012

A dispensation was introduced which allowed for all contributions up to a capped amount per month (fixed at around R530 for main member, R530 for first dependant and R320 for every additional dependant) to be deducted from taxable income. This benefit was available to all medical scheme members, irrespective of whether an employer subsidy was applicable. Persons earning below the tax threshold did not qualify for this tax benefit.

In terms of tax relief for additional medical expenses, you could deduct qualifying expenses exceeding 7.5% of taxable income. This included contributions exceeding the above-mentioned capped amounts. For persons older than 65 years and for handicapped persons, the 7.5% limitation was not applied, hence all expenses and contributions were tax deductible.

## 2013 to current

From 2013, medical tax credits were introduced. This direct credit on tax payable applies to the contributions paid by the taxpayer or his/her employer, to a registered medical scheme and replaced the deductions from taxable income under the previous two dispensations.

The current (2020/2021) tax credit amounts available are R319 per month for the first two dependents and R215 for further dependents. For individuals paying contributions via their employer, i.e. as a deduction from salary or wages, the employer is obliged to use the credit system to adjust monthly pay-as-you-earn (PAYE) tax accordingly. Individuals who pay medical scheme contributions in their own capacity can claim medical tax credits upon submitting their annual tax return. Again, persons earning below the tax threshold do not qualify for this tax benefit. Where employers subsidise medical aid contributions, the value of such subsidies are added to the taxable income of the employee.

The formula used to determine tax credit for medical expenses is quite complicated and depends on age and whether the individual or dependent is disabled.

| Age & disability status | Formula |
|---|---|
| Under 65 without disability | 25% of total contributions paid to the medical scheme |
| | Less (4 x medical scheme fee credit) |
| | Plus (qualifying medical expenses paid, less 7.5% of taxable income) |
| Under 65 with disability | 33.3% of total contributions paid to the medical scheme |
| | Less (3 x medical scheme fee credit) |
| | Plus (qualifying medical expenses paid) |
| 65 and over, with or without disability | 33.3% of total contributions paid to the medical scheme |
| | Less (3 x medical scheme fees credit) |
| | Plus (qualifying medical expenses paid) |

# Examples illustrating the different steps in the calculation to determine tax credit for medical expenses.

## Example - Under 65 WITHOUT a disability

John is 50 years old and pays R8 400 per month to a medical scheme for himself, his wife and their two children. During 2020, he paid R35 000 for medical treatments that were not claimed back from his medical aid, as his savings had been depleted. John's taxable income for the year was R560 000.

### STEP 1 | Calculating John's medical scheme fee credit

**2020/2021**

Flat rate of R319 each for him and his first dependent (his wife),

**plus**

R215 for each of his additional dependents (their children).

**Annual medical scheme fee credit = monthly credit x 12**

(R319 x 2) + (R215 x 2) x 12
= R638 + R430 x 12
= R1068 x 12
= R12 816

### STEP 2 | Calculating excess scheme fees

Applying the formula for someone under 65 years old without a disability.

Excess scheme fee credit = total contributions

**less**

4 x medical scheme credit

(R8 400 x 12) - (4 x R12 816)
= R100 800 - R51 264
= R49 536

### STEP 3 | Determine additional medical expense credit

Subtract 7.5% of John's taxable income from his total out-of-pocket medical costs, plus the excess schemes credit.

Addition medical expenses credit = total qualifying spend

**plus**

Excess schemes credit

**less**

Taxable income x 7.5%

(R35 000 + R49 536) - (R560 000 x 7.5%)
= R84 536 - R42 000
= R42 536

### STEP 4 | Calculating additional medical expenses credit

Remember that the **additional medical expenses** credit is

25% of the sum of excess fees

**and**

Qualifying medical expenses.

So let's work that out!

25% x R42 536
= R10 634

John will receive additional medical expenses tax credit of R10 634 over and above the R12 816 tax credits linked to his monthly contributions.

**The example only illustrates the basic calculation!**

# Other technical aspects

**There are many other technical aspects which need to be considered, including:**

- Which medical scheme's membership and contributions qualify for credits?
  - Membership should be to a registered medical scheme (or similar fund outside South Africa)

- Which dependents qualify?
  - Any "dependents" (as defined in section 6B (1) of the Income Tax Act, 1962). Please refer to the source reference at the end of this document.

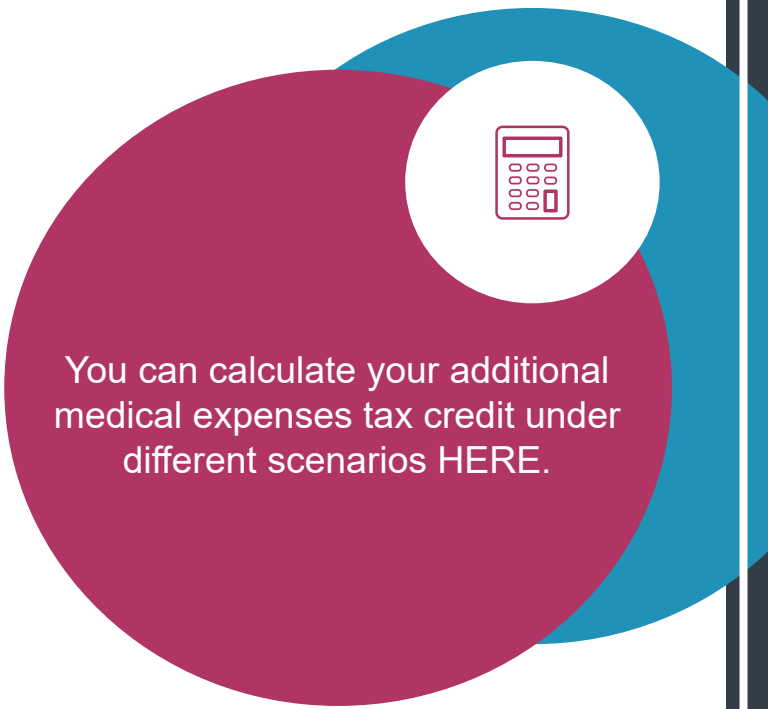
- Which additional expenses qualify?
  - Services rendered and medicines supplied by any duly registered medical practitioner, dentist, optometrist, homeopath, naturopath, osteopath, herbalist, physiotherapist, chiropractor or orthopaedist;
  - Hospitalisation in a registered hospital or nursing home;
  - Home nursing by a registered nurse, midwife or nursing assistant, including services supplied by any nursing agency;
  - Medicines prescribed by any duly registered physician (as listed above) and acquired from any duly registered pharmacist;
  - Expenditure incurred outside South Africa in respect of services rendered or medicines supplied which are substantially similar to the services and medicines listed above;
  - Any expenses prescribed by the Commissioner and necessarily incurred as a result of any physical impairment or disability.

- Who qualifies as disabled?
  - A physical disability can be described as a condition or dysfunction, of a permanent nature, which requires the person who has the condition or dysfunction to use special equipment or receive medical treatment in order to perform general life functions. A temporary condition or illness that can be treated with, for example, medication or exercise, is not regarded as a physical disability. It is not a requirement that the condition result from physical injury.
  - The expense must be directly because of a physical disability suffered by you, your spouse, your or your spouse's children, or any of your dependents.
  - Expenditure incurred in respect of a dependent will only qualify if:
    1. you were a member of a registered medical scheme; and
    2. at the time the expense was paid, the person was admitted as a dependent of yours in terms of the rules of the medical scheme.

- Taxpayers must ensure that the following information is available:
  - Full details of the nature of the physical disability.
  - Evidence that the expense was incurred "in consequence of" the physical disability, that is, directly connected with the physical disability and/or incurred as a necessary result of it.
  - Why was it necessary to incur the expense? Was the expense inevitable, or unavoidable?
  - Completed ITR-DD Confirmation of Diagnosis of Disability form
  - Proof of payment for treatments, prescriptions, etc.

Another aspect to consider is whether it would be beneficial to rather pay contributions and have the additional expenses claimed by the lowest earning spouse versus the higher earning spouse. Generally, the additional expenses credit is higher for lower income persons.

Some medical schemes have their savings "outside" of the medical scheme, for example Momentum's HealthSaver. Any qualifying amounts claimed from the HealthSaver will be regarded as own additional expenses and qualify as such for the additional medical expenses rebate, compared to other schemes where the savings is regarded as part of the scheme. Bear in mind that in the formula to calculate additional expenses tax credits, your contribution is typically lower, which in the formula will lower your credits, but on the other hand the expenses are higher, which pushes up the credit amount.



# Tax credits and affordability

Often, tax credits can assist in making medical scheme membership affordable, even for low-income earners. Keeping in mind that only employees earning above the tax threshold (R87 300 for the 2022 tax year) qualify for tax credits, it means that often the net cost of a medical scheme after tax credits can be very similar to a primary care product, where tax credits do not apply.

Take the example of an employee (Tom), earning R90 000 and being subsidised 50% towards medical scheme membership.

- On Discovery (for example) the lowest option is KeyCare Start, costing R950 for a principal member earning up to R9 150 per month.
- The 50% subsidy on a KeyCare Start option amounts to R475. Annually, R475 x 12 = R5 700 must be added to Tom's taxable salary.
- His taxable salary increases to R95 700.
- 18% tax on the additional income is R1 026; which equates to R85.50 per month.
- Therefore, medical scheme membership in this example for Tom would cost R475, plus the tax on the subsidy (R85,50) less the tax credit benefit (R319).
- The net cost for the employee is therefore R241.50.
- If not subsidised, the net cost would amount to the total premium less the tax credit: R950 – R319 = R631.
- This compares favourably with the cost of a primary care product, costing around R350 to R400 per month, specifically when subsidised.
- The medical scheme benefits are typically much more comprehensive, including Prescribed Minimum Benefit hospital cover.

From the above, it becomes clear that from a tax benefit perspective, primary care products are more suited for employees earning below the tax threshold, where an employer subsidy is not taxed and no tax credit benefit is available.

# National Health Insurance and tax credits

The National Health Insurance (NHI) White Paper indicates Government's intent to phase out tax credits when NHI is implemented. We expect that the benefit will gradually be diluted prior to falling away under NHI. Under NHI, the benefit provided by the state will be in the form of a free/centrally funded basic NHI package available to all citizens.

Sources: https://www.taxtim.com/za/guides/medical-expenses-tax
South African Revenue Service: Tax Guide on The Deduction of Medical Expenses (Issue 2)(2007)
https://www.sars.gov.za
https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G07%20-%20Guide%20on%20the%20determination%20of%20medical%20tax%20credits.pdf

# 02 Gap Cover - comparing benefits

Gap Cover is a short-term insurance policy which provides shortfall cover where doctors and specialists charge above medical aid rates. Gap Cover works in conjunction with your medical aid.

**What are the different types of Gap Cover?**

There are a variety of Gap Cover products available in the marketplace and the different categories of cover can typically be broken down as follows:

**Basic plans**

Provides cover for shortfalls in relation to what percentage specialists charge in hospital and the percentage cover that a medical scheme pays. It is important to note that Gap Cover providers offer benefits in the following two ways:

1. They will stipulate a maximum amount that they are prepared to cover e.g. a maximum of 500% **inclusive** of the amount paid by the medical scheme OR

2. They will stipulate a maximum amount that they will pay on top of what the medical scheme rate is. For example, if you are on a scheme that pays 100% and your Gap Cover plan covers an **additional** 500%, you will then be covered up to a maximum of 600% for any claim submitted, provided of course that the bill comes to more than 600%.

**Comprehensive plans**

These plans typically also provide cover for additional benefits, for example co-payments imposed by a medical scheme, such as MRI and CT scan co-payments, as well as the provision of additional cover for cancer when co-payments are applied by a medical scheme once a member's oncology threshold limit has been reached.

These are just a few of the benefits.

**Comprehensive plans with additional insured benefits**

Over and above the normal comprehensive benefits, these plans provide cover for additional insured benefits, such as premium waiver benefit on death or permanent disability of a policy holder, a once-off lump-sum cancer benefit on first diagnosis of a cancer and a hospital cash-back plan offered by the insurers.

**Gap Cover contributions**

Contributions billed by different insurers vary. Some will charge an individual rate for a single person and then a family rate for one or more dependants, whereas others will charge a family rate only, irrespective of the number of people on the plan. In addition to this, many Gap Cover providers have introduced age-rated premiums for members who are older than 65yrs. Contributions in respect of employer groups taking out Gap Cover for their employees are usually discounted, but will depend on the demographic profile of their employees.

**Waiting periods**

Since the Demarcation Regulations were introduced in 2018, Insurers of Gap Cover products may no longer impose life-long exclusions on pre-existing medical conditions.

The following two underwriting maximums were introduced:

- 3 months general waiting period
- 12 months condition-specific waiting period on pre-existing conditions

This means that any individual applying for membership of any Gap Cover product will know what the maximum period is that they will be unable to access benefits when joining. This legislation will deter people with existing conditions, who are scheduled for hospital admissions or upcoming operations, from joining Gap Cover just to make a claim and then resign. It also allows schemes and existing members some protection against anti-selection of this kind.

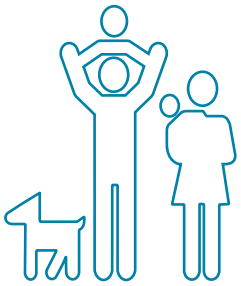
With medical schemes imposing more and more restrictions and co-payments on benefits in order to keep their contribution increases as low as possible, Gap products are becoming critically important if members want to be able to have access to benefits without substantial out of pocket payments.

**Some interesting facts...**

***Estimated***


Gap Cover Policies in existence

Each policy reflects a family (or an individual, if the policyholder is a single adult).



Also ***estimated*** that approximately 35,000 policies have extended family dependants, covering an additional 55,000 individuals.

Total lives covered - approximately **1,1 million**

Statistics provided by Ambledown, a Gap Cover administrator, indicate that

**62%**

of their total Gap claims payable are in respect of specialist fees that are higher than medical scheme rates, and a further

**32%**

of Gap claims are in respect of co-payments charged by medical schemes.

# 03 The Council for Medical Schemes Report and Simeka Health view on medical schemes

**As Healthcare Consultants it is imperative for Simeka Health to provide guidance to clients regarding the sustainability of their medical schemes.**

One of the primary sources of information that enables us to provide such guidance is the Council for Medical Schemes (CMS) Report. The report is published towards the end of the year following the reporting period. The 2019 Report was published towards the end of 2020 and while being somewhat delayed in terms of actual current financial and membership status, it still provides a valuable guide on these aspects.

We have used the unaudited Quarterly Reports published by CMS to further indicate the effect of Covid-19 on these key indicators. As you can clearly see, the effect of non-elective operations being postponed, as well as lower hospitalisation due to less exposure to other risks during lockdown, has saved medical schemes substantial amounts and bolstered reserves strongly as claims ratios came down.

### Industry statistics

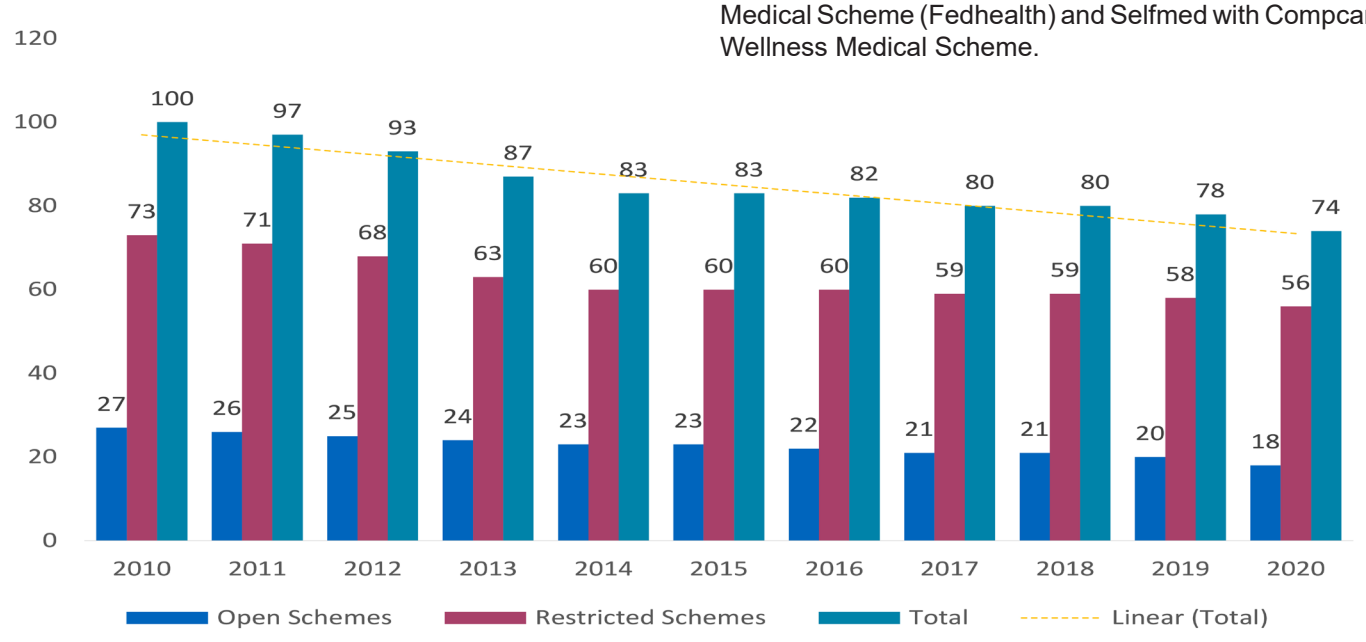
| Subject | 2018 | 2019 | Q3 2020 | Year on year |
|---|---|---|---|---|
| Principal Members | 4 039 705 | 4 062 413 | 4 030 619 | |
| Beneficiaries | 8 916 695 | 8 953 076 | 8 901 342 | |
| Population Coverage | 15.50% | 15.08% | 14.90% | |
| Number of schemes | 79 | 78 | 74 | |
| Solvency | 34.54% | 35.61% | 42.1% | |
| Average age | 32.8 years | 33 years | 33.7 years | |
| Pensioner Ratio | 9.00% | 8.6% | 9.0% | |
| Gross Contribution Income | R192.28b | R205.83b | R165.2b | up by 7% |
| Health Care Expenditure | R174.12b | R187.05b | R120.1b | down by 14% |
| Non-health Care Expenditure | R15.79b | R16.55b | R12.8b | |
| Claims Ratio | 88.70% | 90.58% | 80.10% | down by 13.08% |

### Contribution increases: 2020

The average gross contribution increased for all medical schemes in 2020 was 7.6%. On average, open schemes implemented higher increases in contributions (8.1%) than restricted schemes (6.9%).

### Consolidation

No new medical schemes have been registered during the year under review, with 76 registered schemes in February 2020. During the period under review, Topmed Medical Scheme (Topmed) amalgamated with Fedhealth Medical Scheme (Fedhealth) and Selfmed with Compcare Wellness Medical Scheme.




The 2019 Annual Report of the Council for Medical Schemes (CMS), which was recently released, can be accessed at: https://www.medicalschemes.co.za/annualreport2020/

## Simeka Health's view on medical scheme risk criteria

Every year, Simeka Health reviews our house view of schemes to be offered to clients. The house view is based upon risk aspects related to the scheme profiles depicted below, obtained from the CMS Report, as well as considering the value for money of the different options, based upon a Benefit Richness exercise and servicing aspects as derived from statistics relating to time taken to resolve queries.

The table below provides some insight into several key scheme risk measures which we use in our robust process:

| Scheme | Principal member | Members +/- past 3 years | Average age | Solvency | Nett healthcare result average 3 years | Nett non-health-care expenses pbpm | Past 3 years average increase |
|---|---|---|---|---|---|---|---|
| Bestmed | 95 044 | +293 | 37.4 | 35.43% | 142 266 | R 183 | 9.43% |
| Bonitas | 338 751 | -252 | 33.77 | 24.85% | 8 233 | R 179 | 9.83% |
| Discovery | 1 351 720 | +46 501 | 34.4 | 27.50% | 250 359 | R 205 | 9.43% |
| Fedhealth | 79 815 | +7 612 | 39.37 | 43.43% | -93 630 | R 252 | 10.23% |
| Medihelp | 93 517 | +1 852 | 37.4 | 27.68% | -55 836 | R 164 | 9.47% |
| Medshield | 79 469 | +2 461 | 37.29 | 39.56% | -151 445 | R 189 | 10.47% |
| Momentum | 156 723 | +6 907 | 33.28 | 25.86% | -19 108 | R 200 | 10.00% |
| Sizwe | 46 935 | -1 554 | 33.07 | 36.48% | -194 412 | R 215 | 6.67% |

We arrive at a ranking which provides some guidance to consultants and clients in terms of the sustainability of their schemes to offer competitive benefits. We acknowledge though, that certain schemes are better suited to specific clients for a number of reasons, which could include underwriting concessions, service aspects, specific benefits, culture and geographical location of networks. The schemes included in the table above are in alphabetical order and include the biggest schemes where Simeka Health has membership representation.