

A reasonable exercise of discretion

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him a permanent disability benefit, the benefit will be determined under the normal rules of the fund. Usually, the rules would allow the benefit to be calculated according to the actual years of membership plus a percentage of the remaining years that would have been served had the member continued to work up until retirement age. For example, the disability benefit could be based on his years of membership up to the actual retirement date plus 75% of the years of service that he would have completed from that date up to his normal retirement date.

If Spongebob elects to take one third of the total benefit as a lump sum and the balance in the form of an annuity, he will enjoy some tax relief on the lump sum but the annuity will be fully taxable.

The annuity will be added to any other income that Spongebob may receive each year and taxed at Spongebob's marginal tax rate.

As mentioned in part (a), part of the lump sum is tax-free. The calculation of the tax-free portion is based on his highest annual average salary during any five consecutive years of service with BA and the number of years of membership taken into account by the fund in determining his retirement benefit. The maximum tax-free amount is limited to the greater of R120 000 or R4 500 multiplied by the number of completed years of membership.

The remaining taxable amount of the lump sum (that is, the actual lump sum less the tax-free portion) will be taxed at Spongebob's average tax rate rather than his marginal tax rate, which provides further tax relief. For example, if Spongebob's taxable income including the annuity but before adding in the taxable portion of the lump sum was R400 000 for the year, his average tax rate for the year would be 29,25% whereas his marginal tax rate on any further taxable income would be 40%.

The taxable portion of Spongebob's lump sum would be taxed at the lower rate of 29,25%, unless Spongebob's average tax rate for the previous year of assessment was higher than 29,25%, in which case the previous year's average rate would be used.

In practice, the fund would deduct employees' tax from both the annuities and the lump sum payments and would only pay the remaining amounts to Spongebob. The employees' tax calculated by the fund is, however, not necessarily the final tax determination. Spongebob should still do a full tax calculation at the end of the year, taking into account all of his income and any deductions to which he is entitled to ensure that the correct amount of tax is ultimately paid.

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THE case study raises the interesting question of whether a disability can be classified as permanent if it can be removed by surgery or other medical treatment and when it would be reasonable for a fund or an insurance company to require a member to seek medical intervention.

A limitation clause ordinarily means that the benefit is limited to the cover provided under the insurance policy. The facts of this case study do not provide the details of the applicable conditions imposed by XYZ, which may be relevant.

In a case such as this it would also be important to determine whether the insurance policy provides that the insurer's liability depends on the insurer being of the opinion that the member is permanently disabled because then the only basis on which a member can succeed in having the insurer's repudiation of his claim set aside is if he can show that the insurer did not act reasonably in forming its opinion on the matter (the Supreme Court of Appeal case of *Southern Life Association Ltd v Miller*). However, the trustees must still assess the matter and require that the insurer exercise its discretion reasonably.

In this case, as the BA Fund (or "the fund") gave its own reasons for accepting XYZ's repudiation of the claim, the trustees of the fund were required to apply their minds to determining whether Spongebob qualifies for permanent disability and deciding whether it is reasonable for Spongebob to undergo the surgery recommended.

XYZ repudiated the claim on the basis that as laser surgery might be able to cure Spongebob's eye condition, he could not be considered permanently disabled. The issue of when a disability which, without surgery or medical intervention, would be permanent and would satisfy the requirements of the fund's definition of permanent disability was first considered by the Pension Funds Adjudicator in 2001 in *Hiebner v Metal and Engineering Permanent Disability Scheme* (reported in 2004). As there was then no South African case law in this regard, the adjudicator relied on US case law and from this, the principle arises that unless there is a proviso either in the rules of the fund or in the terms of the insurance policy to the effect that a disability will not be considered permanent if it can be substantially removed by surgery or other medical treatment, the member cannot be required to undergo



an operation in to recover the benefits of the policy.

An example of such a proviso would be: "The disability shall not be considered permanent if it can be substantially removed by surgery or any other medical treatment, which the member, with due allowance for the risk and prognosis of success of such treatment, can reasonably be expected to undergo."

A proviso of this nature is not contrary to public policy and would be binding on a member who, for example, would not submit himself to surgery on religious grounds. He would have to accept the consequences of refusal to submit to surgery if this was considered reasonable in the circumstances.

However, even though there is no such proviso in the rules of the BA Fund, the principle in issue is whether it would be reasonable for the fund to insist that Spongebob undergo the recommended surgery. If a member is required to submit to surgery or other medical treatment to which a reasonable man would submit, provided that the fund has satisfied itself that it is reasonable in the circumstances, the fund cannot be held liable in respect of the outcome. If however it does not, the fund could face a claim for damages in the event of the surgery causing irreparable loss to the member.

In reaching this decision, the fund would have to assess all the available medical evidence and decide objectively what is reasonable in the circumstances. The important point is that the BA Fund must consider what Dr Never and Dr Themba have both advised regarding the risks and chances of success.

On the facts, this is an onerous

decision to make because the fund has been given medical advice by Dr Themba casting doubt on the long term safety and effectiveness of the surgery. As his report stated, there is only a low percentage of patients who achieve 20/20 vision and good vision is an important requirement for a pilot and is therefore the reason why Spongebob's employer has a strict policy in this regard. Not only is there a risk of not adequately correcting Spongebob's eyesight but a possible consequence of the surgery being unsuccessful is him losing his eyesight completely, as did his former colleague.

IT WOULD therefore be incumbent on the BA Fund to require XYZ to justify its decision which was based on the medical report that it obtained from Dr Never as Dr Themba's report contains substantially different medical advice. If XYZ is not able to do this, the fund would be well advised to obtain a further independent medical report because of the conflicting medical advice from Dr Themba and Dr Never.

Spongebob also submitted an affidavit in which he provides evidence of a former colleague who underwent the same surgery and lost his vision. Although the fund could take this collateral information into account, it must be careful in only taking into account relevant considerations and excluding irrelevant considerations in reaching a decision. This affidavit may not necessarily constitute medical evidence which could be relied on as there is no historical or background medical information regarding the individual concerned. By the same token it does provide evidence supporting

Dr Themba's concern about the safety and effectiveness of the surgery and this should therefore be investigated further by the fund.

Apart from the question of surgery, an investigation regarding whether Spongebob can engage in other employment in his profession must also be done before it can be determined whether he has satisfied the requirements for permanent disability in terms of the definition.

Therefore, it is not acceptable for the BA Fund to say that the principles of fairness and good faith necessitate that a member must avail himself of all reasonable means and remedies to correct rather than accept the disability.

Not only is this not stated in the rules, but the fund must determine the reasonableness of whether surgery is appropriate and should not just accept XYZ's repudiation without more.

If the trustees of the BA Fund have not done this then the BA Fund and XYZ should be concerned about Spongebob's decision to appeal the decision to repudiate his application for permanent disability benefits.

As the provision of permanent disability benefits is a fund benefit, the adjudicator does have jurisdiction over a complaint if submitted by Spongebob as the complaint would concern the interpretation and application of the fund's rules. Spongebob could also cite XYZ as a party to the complaint or if he does not, the adjudicator may join XYZ as a party to the complaint.

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