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Backgrounder

LRC 133—Report on Standardized Assumptions for Calculating Income Tax Gross-Up and Management Fees in Assessing Damages

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The principle of compensation is to restore someone who has incurred a loss to the position that person would have been in if no loss had been incurred. Sometimes the effects of loss can extend to the future as, for example, in the award of future care costs in serious personal injury cases. While personal injury damages are not subject to taxation, the income generated by the investment of damage awards for future care costs, loss of dependency, and certain other losses are. If no adjustment is made for income taxation in assessing these damages then the fund will fall short before the intended time of exhaustion. The distorting effect of taxation on damages for costs of future care and on dependency awards can be counteracted by adding an amount to the award. This is the so-called income tax "gross-up."

Gross-up calculations are complex, being based upon both facts and assumptions. Some factors such as a person's age and life expectancy are specific to an individual case, while other elements, such as the future economic climate and tax climate, can be applied more generally. This report examines the possibility of developing a standardized set of assumptions to be used in calculating the income tax gross-up and management fees when they form part of an award of damages for personal injury or under the *Family Compensation Act.* Management fees are an additional amount that in certain circumstances may be included in a damage award to compensate the injured party for the cost of engaging professional assistance in the management and investment of the award. The report arose out of concerns expressed by the legal profession over the length and cost of court proceedings in dealing with these issues and the belief that a set of standard actuarial and economic assumptions would prevent the need for detailed evidence and cross examination on the techniques used by experts to arrive at an appropriate amount in individual cases.

The report explores the various issues and difficulties in attempting to put together a set of assumptions for the income tax gross-up, looking in particular at the different types of factors that are specific to each case and other more general assumptions. It also considers those cases where a management fee will be appropriate and the level of those fees, based on the degree of assistance needed. Alternatives to income tax gross-up and management fees are investigated but the conclusion reached in the report is that none of these options offers a simpler or better solution.

The core recommendation of the report is that standard assumptions should be introduced to aid the calculation of income tax gross-up and management fees. The assumptions are somewhat complex but are drafted to be flexible enough to meet most individual situations. These assumptions are set out in the form of guidelines along with draft enabling legislation.

Further Developments

The report's recommendations have not been implemented by legislation, but its management fee tables have been used in many court cases and it has been cited in a number of judgments.